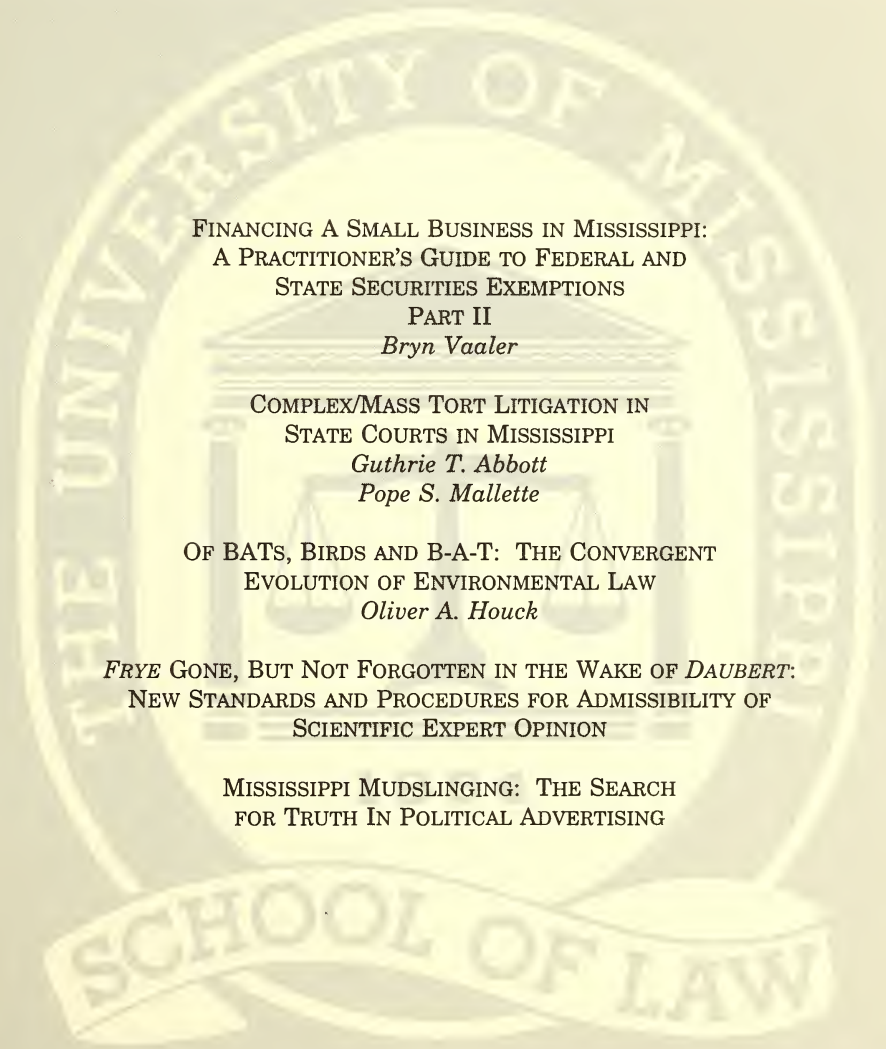


# MISSISSIPPI LAW JOURNAL



FINANCING A SMALL BUSINESS IN MISSISSIPPI:  
A PRACTITIONER'S GUIDE TO FEDERAL AND  
STATE SECURITIES EXEMPTIONS  
PART II

*Bryn Vaaler*

COMPLEX/MASS TORT LITIGATION IN  
STATE COURTS IN MISSISSIPPI

*Guthrie T. Abbott*

*Pope S. Mallette*

OF BATs, BIRDS AND B-A-T: THE CONVERGENT  
EVOLUTION OF ENVIRONMENTAL LAW

*Oliver A. Houck*

FRYE GONE, BUT NOT FORGOTTEN IN THE WAKE OF *DAUBERT*:  
NEW STANDARDS AND PROCEDURES FOR ADMISSIBILITY OF  
SCIENTIFIC EXPERT OPINION

MISSISSIPPI MUDSLINGING: THE SEARCH  
FOR TRUTH IN POLITICAL ADVERTISING

## RECENT DECISIONS OF THE MISSISSIPPI SUPREME COURT



Keep your office informed with a subscription to the *Mississippi Law Journal* briefs of decisions of the Mississippi Supreme Court.

Briefs are written by *Journal* members and mailed by Tuesday of the week after the decisions are rendered, several weeks before cases are printed in the regional reporter. You can receive this weekly publication and be up to date for only \$50.00 per year—an indispensable service! Subscribe now, or write for a free sample of the most current briefs.

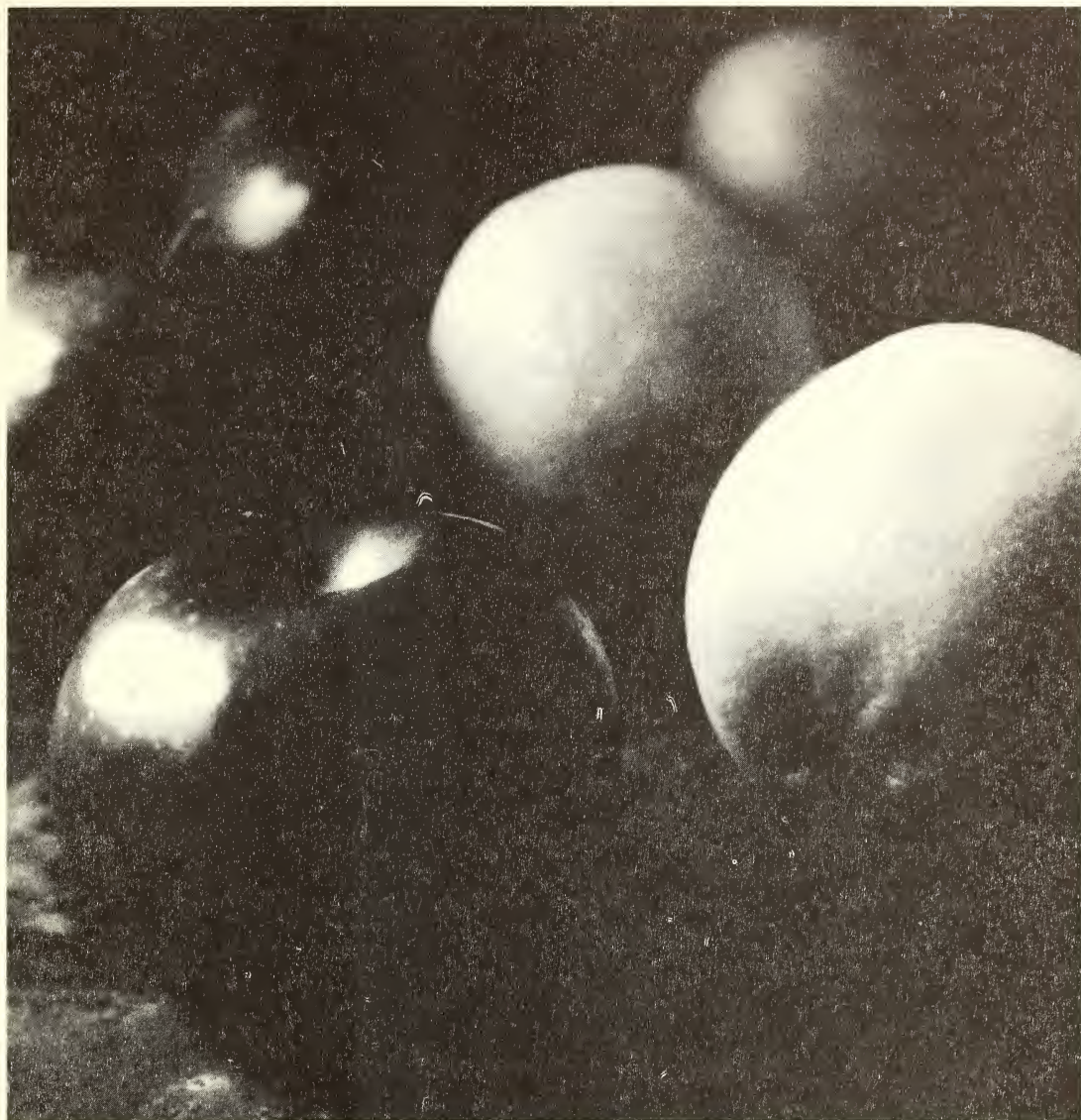
Mississippi Law Journal  
P. O. Box 849  
University, Mississippi 38677-0849

### NOTICE

Change in Subscription Price



UNTIL NOW, TITLE COMPANIES  
WERE ABOUT AS EASY TO COMPARE.



These days, a lot of title companies claim to be financially sound. But too often, what they promote are isolated ratios and statistics that are not a true measure of financial strength. In fact, they are often misleading.

At Mississippi Valley Title, we saw the need for **standardized** claims-paying-ability ratings for title insurers. That's why we asked to be rated by Standard & Poor's. We were given an A+ — the highest rating from S&P in the title industry to date — along with our affiliate and co-underwriter, Old Republic National Title Insurance Company, who received an A+ rating for the second year in a row.

Ask another title company for their rating from Standard & Poor's. If they don't have one, ask why. Then call Mississippi Valley Title.

MISSISSIPPI VALLEY TITLE  
INSURANCE COMPANY

315 Tombigbee Street; P.O. Drawer 2428  
Jackson, MS 39225-2428  
(601) 969-0222 (800) 647-2124 (AL/MS/TN)

ADMINISTRATIVE OFFICERS  
OF THE  
UNIVERSITY OF MISSISSIPPI

R. GERALD TURNER, *Chancellor*  
H. RAY HOOPS, *Vice Chancellor for University Affairs*  
J. LESLIE WYATT, *Vice Chancellor for Executive Affairs*  
DOYLE L. RUSSELL, *Vice Chancellor for Administrative Affairs*  
DONALD PETERS, *Vice Chancellor for Student Affairs*  
DON L. FRUGE, *Vice Chancellor for University Affairs*  
CAROLYN ELLIS STATON, *Acting Dean of the School of Law,*  
*Director of the Law Center and Professor of Law*

THE LAW SCHOOL FACULTY

GUTHRIE T. ABBOTT, *Butler, Snow, O'Mara, Stevens and Cannada*  
*Lecturer in Law and Professor of Law*  
DONNA D. ADLER, *Assistant Professor of Law*  
RICHARD L. BARNES, *Leonard B. Melvin, Jr. Lecturer in Law and*  
*Professor of Law*  
DEBORAH H. BELL, *Director of the Housing Law Clinic and*  
*Associate Professor of Law*  
JOHN R. BRADLEY, *Professor of Law*  
WILLIAM HOUSTON BROWN, *Adjunct Professor of Law*  
LARRY S. BUSH, *Associate Professor of Law*  
WILLIAM M. CHAMPION, *Mississippi Defense Lawyers'*  
*Association Lecturer in Law and Professor of Law*  
HERBERT E. CIHAK, *Director of the Law Library and*  
*Assistant Professor of Law*  
GEORGE C. COCHRAN, *Professor of Law*  
AARON S. CONDON, *Emeritus of Law*  
ROBERT N. DAVIS, *Associate Professor of Law*  
THOMAS R. ETHRIDGE, *Emeritus of Law*  
MICHAEL D. FEATHERSTONE, *Professor of Law*  
DON L. FRUGE, *Vice Chancellor for University Affairs and*  
*Professor of Law*  
EVELYN GANDY, *Visiting Professor and Whitten Chair*  
STEPHEN GOROVE, *Professor Emeritus of Law*  
DUKE GOZA, *Visiting Professor of Law*  
KAREN O. GREEN, *Professor of Law*  
ANNE BROWNLIE GULLICK, *Acting Assistant Professor, Legal Writing*  
JOHN R. HAILMAN, *Adjunct Professor of Law*  
TIMOTHY L. HALL, *Associate Professor of Law*  
MICHAEL H. HOFFHEIMER, *Mitchell, McNutt, Threadgill,*  
*Smith & Sams Lecturer in Law and Associate Professor of Law*  
STANLEY HUGGINS, *Adjunct Professor of Law*



JUDITH KOONS, *Assistant Clinical Professor, Housing Law Clinic*  
ROBERT C. KHAYAT, *Professor of Law*  
THOMAS R. MASON, *Associate Dean and Professor of Law*  
GARY MYERS, *Associate Professor of Law*  
LARRY J. PITTMAN, *Assistant Professor of Law*  
SYLVIA ROBERTSHAW, *Acting Assistant Professor, Legal Writing*  
JAY R. ROBINSON, *Adjunct Professor of Law*  
RONALD J. RYCHLAK, *Mitchell, McNutt, Threadgill, Smith and  
Sams Lecturer in Law and Associate Professor of Law*  
CAROLYN ELLIS STATON, *Acting Dean of the School of Law and  
Professor of Law*  
GEORGE W. STENGEL, *Professor Emeritus of Law*  
NOAH S. SWEAT, JR., *Professor of Law*  
BRYN R. VAALER, *Associate Professor of Law*  
ROBERT A. WEEMS, *Professor of Law*  
A.C. WHARTON, *Adjunct Professor of Law*  
AMY WHITTEN, *Adjunct Professor of Law*

WE PROVIDE

---

MORE ASSET MANAGEMENT SERVICES

---

IN ONE LOCATION

---

THAN ANY OTHER ORGANIZATION

IN MISSISSIPPI.





# Mississippi Law Journal

Published by Students at the  
University of Mississippi School  
of Law

---

---

VOLUME 63

WINTER 1994

NUMBER 2

---

---

Copyright © 1994, Mississippi Law Journal, Inc.

*Editor in Chief*  
JOHN J. HEALY, III

*Assistant Editor*  
BRADLEY W. SMITH

*Business Manager*  
G. CLARK MONROE II

*Managing Editor*  
MARK H. TYSON

*Articles Editors*  
GOODLOE LEWIS  
SHELBY RICKETTS  
HOLLEY DAVIS THAMES

*Comment Editors*  
SAMUEL ANDERSON  
GENA NOBILE CORY  
SAMMY L. WOOD

*Case Note Editors*  
JACKYE L. CHAPMAN  
DEANNE M. MOSLEY  
MANDI NORTON

*Mississippi Cases Editors*  
THOMAS L. CARPENTER  
WALTER ALAN DAVIS  
JOHN HOLADAY

*Citations Editor*  
CAROLE ESTES

*Index & Review Editor*  
MARGARET MURDOCK

*Alumni Director*  
WADE SWEAT

*Symposium Editor*  
GIGI GAERIG

*Case Notes Competition Chairmen*  
CARMEN M. SHINDALA  
ALAN K. SUDDUTH

*Special Project Editors*  
RYAN E. BYRNE  
MICHAEL V. CORY, JR.

*Administrative Assistant*  
PEGGY C. NAIL

*Faculty Advisors*  
GUTHRIE T. ABBOTT  
DEBORAH H. BELL  
MICHAEL HOFFHEIMER

## STAFF

GEORGE E. ABDO III  
MARK AQUADRO  
SHELDON G. ALSTON  
MARK AQUADRO  
WILLIAM G. ARMISTEAD  
CHRISTINE BATEMAN  
CANDACE FERRELL BHAVSAR  
GERRY M. BLAKER II  
JOSHUA BRAUNSTEIN, JR.  
SARA FRANCES BRENT  
BARRY BRIDGFORTH  
MICHAEL CAPLES  
RICK CIREO  
CHRISTY CROCKETT  
MIKE CRONIN  
HENRY DICK, III  
BRAD DILLARD  
JASON EHRLINSPIEL  
DONALD E. EICHER, III  
CHARLES FERGUSON  
SAM GOZA  
MARK GRIFFIN  
BRAD HATHAWAY  
ROB HOSKYN  
PAUL HURST  
AMY JACKSON  
JAMES MCCULLOUGH, II

WHIT MCKINLEY  
TAD MCRANEY  
TRACE D. MCRANEY  
JEFFERY A. MANNISTO  
DAVID MARON  
LISA MEGGS  
GRANT MONROE  
STEVE MONTAGNET  
JEAN RENEE MOORE  
CRAIG ORR  
LANNY PACE  
MICHAEL PARSONS  
MATT POWERS  
FRED PRUNER  
RICK PYPER  
BRETT ROBINSON  
LEE RIKARD  
GARY RIKARD  
RUSSELL SHAW  
MARK SMITH  
JOHN B. SNEED, III  
REID STANFORD  
PHILLIP SYKES  
OSCAR THOMAS  
BRITT VIRDEN  
MISTY WAKELAND  
WILLIAM WALTER

# Mississippi Law Journal

Published by Students at the  
University of Mississippi School  
of Law

---

---

VOLUME 63

WINTER 1994

NUMBER 2

---

---

Copyright © 1994, Mississippi Law Journal, Inc.

## TABLE OF CONTENTS

### ARTICLES

- FINANCING A SMALL BUSINESS IN MISSISSIPPI: A PRACTITIONER'S  
GUIDE TO FEDERAL AND STATE SECURITIES EXEMPTIONS  
PART II ..... *Bryn Vaaler* 267
- COMPLEX/MASS TORT LITIGATION IN STATE COURTS  
IN MISSISSIPPI ..... *Guthrie T. Abbott*  
*Pope S. Mallette* 363
- OF BATs, BIRDS AND B-A-T: THE CONVERGENT EVOLUTION  
OF ENVIRONMENTAL LAW ..... *Oliver A. Houck* 403

### COMMENTS

- FRYE* GONE, BUT NOT FORGOTTEN IN THE WAKE OF *DAUBERT*:  
NEW STANDARDS AND PROCEDURES FOR ADMISSIBILITY OF  
SCIENTIFIC EXPERT OPINION ..... *Holley Davis Thames* 473
- MISSISSIPPI MUDSLINGING: THE SEARCH FOR TRUTH IN  
POLITICAL ADVERTISING ..... *Lance Conn* 507



**The *Mississippi Law Journal***  
in conjunction with the  
**Mississippi Secretary of State  
Securities Division**

is pleased to offer

**FINANCING A SMALL BUSINESS IN  
MISSISSIPPI: A PRACTITIONER'S GUIDE  
TO FEDERAL AND STATE SECURITIES  
EXEMPTIONS  
PARTS I & II**

***Bryn Vaaler***

This publication is bound in a single, convenient desk-book reference and is a must for the Mississippi law firm or attorney whose practice includes business and transactional work.

To order this useful reference. . .

- The cost of each desk-book reference is \$10.00 (postage and handling included). The *Journal* will bill you or your firm at the time of shipping;
- To order by phone, call the *Mississippi Law Journal* office at (601) 232-7361, ext. 111; or
- To order by Fax (601) 232-7731
- Include name, mailing address and phone number

# FINANCING A SMALL BUSINESS IN MISSISSIPPI: A PRACTITIONER'S GUIDE TO FEDERAL AND STATE SECURITIES EXEMPTIONS PART II†

*Bryn Vaaler\**

|      |                                                                                        |     |
|------|----------------------------------------------------------------------------------------|-----|
| I.   | Introduction                                                                           |     |
| II.  | Development and Current Status of Regulation D<br>Under the Securities Act             |     |
| III. | Other Principal Securities Act Exemptions for Small<br>Business Financing . . . . .    | 270 |
| A.   | The Section 4(2) Private Placement Exemption . . . . .                                 | 270 |
| 1.   | General . . . . .                                                                      | 270 |
| 2.   | Rule 506 and the Statutory Section 4(2) Exemption:<br>A Practical Evaluation . . . . . | 279 |
| B.   | Rule 701: Exemption for Compensatory Plans and<br>Contracts . . . . .                  | 286 |
| 1.   | General . . . . .                                                                      | 286 |

---

† Part I of this article, containing Section I (Introduction) and Section II (Development and Current Status of Regulation D under the Securities Act), was published as *Financing a Small Business in Mississippi: A Practitioner's Guide to Federal and State Securities Exemptions (Part I)*, 63 MISS. L.J. 129 (1993).

\*Associate Professor of Law, University of Mississippi. The author gratefully acknowledges the assistance of Michael Henry and Tammy Harthcock, Senior Staff Attorneys, Securities Division, Mississippi Secretary of State, and Charles L. Potuznik of the law firm of Dorsey & Whitney, Minneapolis, Minnesota. Lisa D'Ambrosia, a 1993 graduate of the University of Mississippi Law School, and Rick Pyper, a second-year student at the University of Mississippi Law School, provided helpful research assistance. The author also gratefully acknowledges the Lamar Order for providing funding to support this research.

|     |                                                                                             |     |
|-----|---------------------------------------------------------------------------------------------|-----|
| a.  | Compensatory Transactions, Nonpublic Companies<br>and the Federal Securities Law .....      | 286 |
| b.  | Adoption of Rule 701 .....                                                                  | 288 |
| c.  | Form S-8 Revisions .....                                                                    | 289 |
| 2.  | Exemption for Compensatory Plans and Contracts ..                                           | 290 |
| a.  | Availability of the Exemption .....                                                         | 290 |
| b.  | Compensatory Purpose .....                                                                  | 291 |
| c.  | Definition of "Compensatory Benefit Plan" ....                                              | 293 |
| d.  | Applicability to Pre-March 20, 1988 Offers and<br>Post-IPO Sales .....                      | 294 |
| e.  | Conditions To Be Met .....                                                                  | 295 |
| 3.  | Disclosure .....                                                                            | 303 |
| 4.  | Limitation on Resale .....                                                                  | 304 |
| 5.  | Form 701 .....                                                                              | 306 |
| C.  | The Intrastate Exemption .....                                                              | 306 |
| 1.  | General .....                                                                               | 306 |
| 2.  | Availability of the Exemption .....                                                         | 311 |
| 3.  | Residency of the Issuer .....                                                               | 312 |
| 4.  | Doing Business Within the State .....                                                       | 313 |
| 5.  | Residency of Offerees and Purchasers .....                                                  | 316 |
| 6.  | Part of an Issue .....                                                                      | 320 |
| 7.  | Limitation on Resale .....                                                                  | 321 |
| IV. | Mississippi Blue Sky Exemptions for Small Business Financing                                | 323 |
| A.  | Background .....                                                                            | 323 |
| B.  | Principal Mississippi Blue Sky Exemptions for Small<br>Business Financing .....             | 326 |
| 1.  | Institutional Exemption: Section 75-71-203(8) and<br>Rule 103(G) .....                      | 327 |
| a.  | Background .....                                                                            | 327 |
| b.  | Qualified Institutional Buyers .....                                                        | 328 |
| c.  | Accredited Investors .....                                                                  | 330 |
| d.  | Residual Content of "Institutional Buyer" ....                                              | 331 |
| 2.  | Limited Offering Exemption: Section 75-71-203(9) ..                                         | 332 |
| a.  | Background .....                                                                            | 334 |
| b.  | Counting Rules .....                                                                        | 336 |
| c.  | Exemption for Preorganization Certificates or<br>Subscriptions: Section 75-71-203(10) ..... | 337 |
| 3.  | Uniform Limited Offering Exemption: Rule 703 ...                                            | 338 |

|    |                                                                                                                                                                       |     |
|----|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| a. | Background . . . . .                                                                                                                                                  | 338 |
| b. | Standard ULOE . . . . .                                                                                                                                               | 339 |
| c. | Mississippi ULOE . . . . .                                                                                                                                            | 342 |
| 4. | Domestic Issuer Limited Offering Exemption:                                                                                                                           |     |
|    | Rule 705 . . . . .                                                                                                                                                    | 344 |
| a. | Conditions . . . . .                                                                                                                                                  | 344 |
| b. | Counting Rules . . . . .                                                                                                                                              | 346 |
| 5. | Other Exemptions . . . . .                                                                                                                                            | 347 |
| a. | Existing Security Holders Exemption:                                                                                                                                  |     |
|    | Section 75-71-203(11) . . . . .                                                                                                                                       | 347 |
| b. | Employee Benefit Plan Transactions:                                                                                                                                   |     |
|    | Section 75-71-201(11) . . . . .                                                                                                                                       | 349 |
| 6. | Relationship Among the Exemptions . . . . .                                                                                                                           | 351 |
| C. | SCOR: Form U-7 . . . . .                                                                                                                                              | 355 |
| 1. | Background . . . . .                                                                                                                                                  | 355 |
| 2. | SCOR and the Small Business Initiatives — Use with<br>Revised Regulation A and the Transitional S-B System                                                            | 357 |
| 3. | SCOR in Mississippi . . . . .                                                                                                                                         | 358 |
| D. | Suggested Revisions . . . . .                                                                                                                                         | 358 |
| 1. | Inclusion of Accredited Investors as “Other<br>Institutional Investors” . . . . .                                                                                     | 359 |
| 2. | Elimination of Filings as Condition to the Rule 703<br>and Rule 705 Exemptions . . . . .                                                                              | 360 |
| 3. | Elimination of Restrictions in Section 75-71-203(9)<br>and Rule 705 on Offers by Persons Other than Officers,<br>General Partners and Registered Broker-Dealers . . . | 360 |
| 4. | Adoption of ULOE Due Diligence Defense to “Bad Boy”<br>Disqualification . . . . .                                                                                     | 361 |

#### EDITOR'S NOTE:

*In Financing a Small Business (Part I), Professor Vaaler reviewed comprehensively Regulation D under the Securities Act of 1933 which contains three of the most important federal exemptions from registration available for small business financing. In Part II, Professor Vaaler outlines three other federal exemptions which are important to small businesses. Finally, the article surveys relevant exemptions under the Mississippi Uniform Securities Act.*



### III. OTHER PRINCIPAL SECURITIES ACT EXEMPTIONS FOR SMALL BUSINESS FINANCING

#### A. *The Section 4(2) Private Placement Exemption*

##### 1. *General*

Section 4(2) of the Securities Act of 1933 exempts from registration "transactions by an issuer not involving any public offering."<sup>381</sup> From the time of its enactment until adoption of the Rule 146 safe harbor by the SEC in 1974, these words provided the sole means by which an issuer could make an exempt private offering under the Securities Act.<sup>382</sup> Early

---

<sup>381</sup> 15 U.S.C. § 77d(2) (1988). For books and articles discussing the statutory § 4(2) exemption, see J. WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933, vols. 7-7D, SECURITIES LAW SERIES, § 11.01-15 (rev. ed. 1993); RICHARD W. JENNINGS, ET AL., SECURITIES REGULATION — CASES AND MATERIALS 322-43 (7th ed. 1992); 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1350-89 (3d ed. 1989); Marc H. Morgenstern, Private Placement Guidelines — A Lawyer's Letter to a First-Time Issuer, 48 BUS. LAW. 257 (1992); B. W. Nimkin, *Offeree Sophistication in Private Offerings*, 15 REV. SEC. REG. 863 (Aug. 25, 1982); Carl W. Schneider, *The Statutory Law of Private Placements*, 14 REV. SEC. REG. 869 (Aug. 26, 1981).

<sup>382</sup> The legislative history of § 4(2) is skimpy and not very helpful. See generally HICKS, *supra* note 381, § 11.01[2]; 3 LOSS & SELIGMAN, *supra* note 381, at 1350-52; Nimkin, *supra* note 381, at 864 n.9; Schneider, *supra* note 381, at 870. The exemption was conceived to apply to a "[s]pecific or isolated sale . . . to a particular person . . . [w]here there is no practical need for the bill's application, . . . [w]here the public benefits [of registration] are too remote . . . [u]nless the stockholders are so small in number that the sale to them does not constitute a public offering." H.R. Rep. No. 85, 73d Cong., 1st Sess. 5, 7, 15-16 (1933). The exemption drew its origins from comparable provisions in the English Companies Act of 1929 as well as a number of state blue sky statutes in existence at the time. See HICKS, *supra* note 381, § 11.01[2]; James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 34 & 37 (1959).

As originally enacted, the exemption was numbered § 4(1) and read: "[T]ransactions by an issuer *not with or through an underwriter* and not involving any public offering" (emphasis added). In 1934, the reference to an underwriter was removed. The revision was not intended to alter the exemption substantively, but simply to delete language deemed superfluous: "There can be no underwriter within the meaning of the act in the absence of a public offer." H.R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934). In 1964, the exemption was relocated from § 4(1) to § 4(2). See Act of August 20, 1964, § 12, 78 Stat. 580 (1964).

interpretive guidance on the scope of the section 4(2) private placement exemption came from a 1935 opinion of the SEC's General Counsel which focused on the number of offerees as a primary consideration, indicating that "under ordinary circumstances an offering to not more than approximately twenty-five persons is not an offering to a substantial number and presumably does not involve a public offering."<sup>383</sup> The opinion went on to enumerate the important factors in determining availability of the exemption as: (1) number of offerees; (2) relationship of the offerees to each other; (3) relationship of the offerees to the issuer; (4) number of units offered; (5) size of the offering; and (6) manner of the offering.<sup>384</sup>

The leading interpretive case on the section 4(2) exemption is *SEC v. Ralston Purina Co.*,<sup>385</sup> which remains the only Supreme Court interpretation of the private placement exemption. In *Ralston Purina*, the Court found the section 4(2) exemption unavailable for Ralston Purina's offerings of treasury stock to certain "key" employees.<sup>386</sup> In doing so, the Court rejected the notion that the number of offerees was the primary consideration.<sup>387</sup> Instead, the Court announced a two-part test for

---

<sup>383</sup> See Securities Act Release No. 285, 1 Fed. Sec. L. Rep. (CCH) ¶ 2740 (1935).

<sup>384</sup> *Id.* While subsequent case law and safe harbor rules (Rules 146 and 506) have indicated that some of the factors cited in the SEC's 1935 opinion are of little real importance and that availability of the exemption will depend on additional factors not explicitly mentioned in the opinion, it remains customary for courts to begin analysis of § 4(2) issues by reciting some variation of these listed factors. See, e.g., *Mark v. FSC Sec. Corp.*, 870 F.2d 331, 333 (6th Cir. 1989); *Sorrell v. SEC*, 679 F.2d 1323, 1326 (9th Cir. 1982); *Mary S. Krech Trust v. The Lakes Apartments*, 642 F.2d 98, 101 (5th Cir. 1981); *SEC v. Murphy*, 626 F.2d 633, 644-45 (9th Cir. 1980); *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 900 (5th Cir. 1977); *Weprin v. Peterson*, 736 F. Supp. 1124, 1129 (N. D. Ga. 1988); *Stoppelman v. Owens*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,511, at 98,579 (D.D.C. 1984), *aff'd mem.* 762 F.2d 138 (D. C. Cir. 1985); *SEC v. Manus*, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,307, at 91,921 (S.D.N.Y. 1981); *Barrett v. Triangle Mining Corp.*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,438, at 99,210 (S.D.N.Y. 1976); see also HICKS, *supra* note 381, § 11.01[3]; *Schneider*, *supra* note 381, at 870-71.

<sup>385</sup> 346 U.S. 119 (1953).

<sup>386</sup> *Ralston Purina*, 346 U.S. at 127. For an in-depth analysis of the facts, the lower court opinions and the Supreme Court's opinion, see HICKS, *supra* note 381, § 11.03.

<sup>387</sup> *Ralston Purina*, 346 U.S. at 125-27. The Court thereby rejected the so-called rule of 25 urged by the SEC:

determining whether an offering is nonpublic. The test requires that an issuer prove that: (1) no offeree needs the protection that registration affords and (2) each offeree had access to the kind of information that would be provided in a registration statement.<sup>388</sup> The focus is on the nature (need for protection; access to information), not the number, of investors, and on the offerees, not the ultimate purchasers.<sup>389</sup> The Court also held that the burden of proving the availability of the exemption is on the issuer claiming it.<sup>390</sup>

Deprived of any sort of numerical safe harbor, judicial decisions following the *Ralston Purina* case struggled to

---

The Commission would have us go one step further and hold that 'an offering to a substantial number of the public' is not exempt under § 4(1). . . . But the statute would seem to apply to a "public offering" whether to few or many. It may well be that offerings to a substantial number of persons would rarely be exempt. Indeed nothing prevents the Commission, in enforcing the statute, from using some kind of numerical test in deciding when to investigate particular exemption claims. But there is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation.

*Id.* at 125. In support of its position that the number of investors does not dominate the public versus private nature of the offering, the Court cited dictum of Viscount Sumner in a British case interpreting the Companies Act analog to § 4(2): "The 'public'. . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole." *Ralston Purina*, 346 U.S. at 125 n.11 (quoting *Nash v. Lynde*, 1929 App. Cas. 158, 169).

<sup>388</sup> *Id.* at 124-26. The Court devised these requirements in light of the purpose of the Securities Act by stating that "[t]he design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. The natural way to interpret the private offering exemption is in light of the statutory purpose." *Id.* at 124-25 (footnotes omitted).

<sup>389</sup> *Id.* at 127. The Court stated, "The focus of inquiry should be on the need of the offerees for the protections afforded by registration." *Id.* The purchasers in the *Ralston Purina* employee offerings numbered in the hundreds; no record had been kept of the identity or number of offerees other than that they were all *Ralston Purina* employees. *Id.* at 121. Limiting the offering to employees did not ensure that the qualitative test was met. The Court, however, noted that "some employee offerings may come within § 4(1), e.g., one made to executive personnel who because of their position have access to the same kind of information that the Act would make available in the form of a registration statement." *Id.* at 125-26.

<sup>390</sup> *Id.* at 126. The Court stated, "Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable." *Id.*



assimilate the old guideline factors and the Supreme Court's new "needs" and "access" tests. The results were often inconsistent and confusing. A disproportionately large number of significant post-*Ralston Purina* decisions were decided by the Court of Appeals for the Fifth Circuit.<sup>391</sup> In *Hill York Corp. v. American International Franchises, Inc.*,<sup>392</sup> thirteen investors purchased \$5,000 in stock of a fast-food franchising corporation. The purchasers, who were "not the average man in the street," were all sophisticated businessmen and lawyers who intended to do business with the issuer.<sup>393</sup> Affirming the lower court's judgment awarding rescission and damages to the plaintiff-purchasers for violations of section 5 and section 12(2) of the Securities Act, the Fifth Circuit panel rejected the notion that a high degree of business or legal sophistication on the part of the offerees would be enough to establish the exemption absent real access to the informational equivalent of a registration statement.<sup>394</sup> If the investors did not have such information, "they could not bring their sophisticated knowledge of business affairs to bear in deciding whether or not to invest."<sup>395</sup> The court in *Hill York* emphasized the importance of the relationship between the offerees and the issuer in meeting the information requirement:

The definition of a class to which an offer of securities can be made in reliance on the private offering exemption may, accordingly, be summarized as follows: where the number of offerees is so limited that they may constitute a class of persons having such a privileged relationship with the issuer that their present knowledge and facilities for acquiring information about the issuer would make registration unnecessary for their protection, then the exemption is available.

---

<sup>391</sup> For discussion of the judicial decisions in the Fifth Circuit and elsewhere during the period from *Ralston Purina* to Rule 146, see JENNINGS, ET AL. *supra* note 381, at 331-33; LOSS & SELIGMAN, *supra* note 381, at 1371-89; Nimkin, *supra* note 381, at 865-69.

<sup>392</sup> 448 F.2d 680 (5th Cir. 1971).

<sup>393</sup> *Hill York*, 448 F.2d at 690.

<sup>394</sup> *Id.* at 690. The Fifth Circuit stated, "Although this evidence is certainly favorable to the defendants, the level of sophistication will not carry the point." *Id.*

<sup>395</sup> *Id.*

Conversely, the term "public offering" must refer to all offerings of securities where the public interest is not remote and the relationship between the issuer and the offeree does not create special advantage in the offerees substantially different from the status of members of the public at large to be able to obtain all necessary information about the issuer and its securities.<sup>396</sup>

In *SEC v. Continental Tobacco Co. of South Carolina*,<sup>397</sup> the Fifth Circuit panel focused on the "privileged relationship" and the "special advantage" discussed in the *Hill York* dictum. The case involved an unregistered offering to "dentists, physicians, housewives and businessmen" with no previous relationship to the issuer.<sup>398</sup> The district court had found that the offerees "were furnished and/or provided access to the same kind of information that would have otherwise been provided in a registration statement"<sup>399</sup> sufficient to support a section 4(2) exemption. However, the Fifth Circuit panel reversed, reasoning that disclosure alone was not enough and that section 4(2) requires proof that "all of the offerees . . . enjoyed a relationship with [the issuer] making registration unnecessary."<sup>400</sup> The clear implication of *Continental Tobacco*, that the *Ralston Purina* "needs" and "access" tests could only be met by insiders of the issuer or others possessing a special relationship to the issuer giving them access, was met with heavy criticism.<sup>401</sup>

---

<sup>396</sup> *Id.* at 688 n.6.

<sup>397</sup> 463 F.2d 137 (5th Cir. 1972).

<sup>398</sup> *Continental Tobacco*, 463 F.2d at 158.

<sup>399</sup> *Id.* at 159.

<sup>400</sup> *Id.* at 161.

<sup>401</sup> See, e.g., Tom A. Alberg & Martin E. Lybecker, *New SEC Rule 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities*, 74 COLUM. L. REV. 622, 629 (1974); Homer Kripke, *Wrap-Up*, 29 BUS. LAW. 185, 187 (Mar. 1974 — Special Supplement); Harold Marsh, Jr., *Who Killed the Private Offering Exemption? — A Legal Whodunit*, 71 NW. U. L. REV. 470, 476 (1976). Professor Kripke summed up the critical reaction to the case and the limited view of § 4(2) espoused in the SEC's brief, as follows: "[T]he Commission, in order to win a case in the Fifth Circuit, came out with the *Continental Tobacco* brief, and did its best to destroy venture capital financing — an absolutely unnecessary position in order to win a case that [it] could have won on much narrower grounds." Kripke, *supra*, at 187. At least one SEC commissioner criticized the position taken by the SEC in the case in contemporaneous remarks:



Three years later in *Woolf v. S.D. Cohn & Co.*,<sup>402</sup> the Fifth Circuit panel reiterated that disclosure alone is insufficient and that offeree sophistication is also required.<sup>403</sup> Although both are important, neither "disclosure" nor "sophistication" alone is enough.<sup>404</sup> The court, however, explained that its *Continental Tobacco* decision had not meant that "insider" status was a mandatory requirement:

In any event, we cannot agree with those critics who read the *Continental* case to require that the offerees have 'insider' status. We read it as requiring that there be disclosure of the information registration would have revealed to each offeree, with the caveat that such disclosure is not in itself sufficient to qualify for the exemption. This is the main refinement *Continental* added to the test in *Hill York*.<sup>405</sup>

In *Doran v. Petroleum Management Corp.*,<sup>406</sup> the Fifth Circuit panel confirmed that the information requirements of the section 4(2) exemption could be met by *either* access or

---

Some commentators have suggested (and I believe there is merit in their suggestions) that this language [in the SEC brief] could be read to mean that a permissible private placee must have a position with the company similar to that of an insider in the 10b-5 sense. If such an interpretation were to prevail, it could lead to such a narrowing of the exemption that even an institutional investor could not qualify. This is certainly not a conclusion which I can support; in fact, I do not believe it was intended by the Commission. My interpretation of the Commission's position in this case is that (1) the offerees must be shown to have access to material information concerning the issuer and (2) the access criteria cannot be met by merely providing, gratuitously, a promotional prospectus purporting to afford instant access and by having each offeree and purchaser sign a letter saying he has received and read such document.

Address by Commissioner Hugh F. Owens before the National Association of Securities Dealers, Inc., reprinted in 152 SEC. REG. & L. REP. (BNA) at G-2 (May 17, 1972); see also 3 LOSS & SELIGMAN, *supra* note 381, at 1374 n.421. For a somewhat less critical analysis of the case, see J. Michael Rediker, *The Fifth Circuit Cracks Down on Not-So-Private Offerings*, 25 ALA. L. REV. 289, 312-13 (1973).

<sup>402</sup> 515 F.2d 591 (5th Cir. 1975), vacated on other grounds, 426 U.S. 944 (1976), cert. denied, 434 U.S. 831 (1977).

<sup>403</sup> *Woolf*, 515 F.2d at 611-13.

<sup>404</sup> *Id.* at 612.

<sup>405</sup> *Id.* at 612-13.

<sup>406</sup> 545 F.2d 893 (5th Cir. 1977).

disclosure<sup>407</sup> and that insider status or any other special relationship to the issuer was only required in order to prove access.<sup>408</sup> The *Doran* decision also confirmed that, however the information requirement was achieved, information alone was not enough. The court will also "weigh other factors such as the manner of the offering and the investment sophistication of the offerees."<sup>409</sup>

In 1974, the SEC responded to requests for guidance in understanding and using the private placement exemption by adopting Rule 146 which was designed to provide a safe harbor within the statutory exemption.<sup>410</sup> Rule 146 provided the first

---

<sup>407</sup> *Doran*, 545 F.2d at 905-06.

<sup>408</sup> *Id.* The Fifth Circuit noted:

Once the alternative means of coming within the private placement exemption are clearly separated, we can appreciate the proper role to be accorded the requirement that the offerees occupy a privileged or 'insider' status relative to the issuer. That is to say, when the issuer relies on 'access' absent actual disclosure, he must show that the offerees occupied a privileged position relative to the issuer that afforded them an opportunity for effective access to the information registration would otherwise provide. When the issuer relies on actual disclosure to come within the exemption, he need not demonstrate that the offerees held such a privileged position.

*Id.* at 905-06.

The *Doran* court explained the *Continental Tobacco* decision as dealing only with the access side of the disjunctive requirement. *Id.* at 907. The court also noted that an offeree could be a "transactional insider" even though such offeree had no previous relationship to the issuer:

That all offerees are in certain respects "insiders" does not ensure that the issuer will gain the private placement exemption. An insider may be an insider with respect to fiscal matters of the company, but an outsider with respect to a particular issue of securities. He may know much about the financial structure of the company, but his position may nonetheless not allow him access to a few vital facts pertaining to the transaction at issue. If *Doran* had effective access to all information that registration would provide, he would be a transactional insider. That is all we require regarding the availability of information. If, on the other hand, his inside knowledge was incomplete or his access ineffective, he would be a transactional outsider despite the fact that we might consider him an 'insider' for other purposes.

*Id.* at 906 n.18.

<sup>409</sup> *Id.* at 907.

<sup>410</sup> See Adoption of Rule 146, Securities Act Release No. 5487, 1 Fed. Sec. L. Rep. (CCH) ¶ 2710, at 2902-08 (Apr. 23, 1974) [hereinafter Rule 146 Adopting Release]. Typical of the calls for guidance were the comments of former SEC Chairman Ray Garrett (while still in private practice), characterizing that:

objective guidelines for compliance, but in many respects imposed conditions to the exemption that had not been embraced by prior judicial decisions. The basic elements of the Rule 146 safe harbor included:

(1) *Qualification of offerees.* Offers could only be made to persons the issuer reasonably believed had such knowledge and experience in financial and business matters that they were either capable of evaluating the merits and risks of the prospective investment *or* were able to bear the economic risk of the investment.<sup>411</sup>

(2) *Qualification of purchasers.* Sales could only be made to persons the issuer reasonably believed, after reasonable inquiry, either had the investment sophistication required of offerees or employed an offeree representative possessing such investment sophistication and were able to bear the economic risk of the investment.<sup>412</sup>

(3) *Limited number of purchasers.* Rule 146 did not impose a specific numerical limit on offerees. Purchasers were limited, however, to thirty-five as counted under the Rule 146 counting rules.<sup>413</sup>

(4) *Access to or furnishing information.* Rule 146 required "access" to information comparable to that disclosed by a prescribed registration statement or receipt by the investor of such information.<sup>414</sup> In the SEC's view, expressed in the Rule

---

[The pre-Rule 146 state of the law is] a kind of mishmash. The issuer is now told that all of these factors have something to do with whether he has an exemption under Section 4(2), but he is never given a hint as to the proper proportions in the brew. The saving recipe is kept secret, a moving target which he can never be sure he has hit.

Ray Garrett, *The Private Offering Exemption Today*, FOURTH ANNUAL INSTITUTE ON SECURITIES REGULATION 3, 10-11 (PLI 1973).

<sup>411</sup> See Rule 146 Adopting Release, *supra* note 410, at 2907-7. While the offeree sophistication requirement had ample (if somewhat confusing) case law precedent, the ability-to-bear-risk requirement was new. The most the SEC could say about the novel requirement was that it was "not inconsistent with the discussion in *Ralston Purina* about the offeree's ability to fend for himself." Rule 146 Adopting Release, *supra* note 410, at 2907-4.

<sup>412</sup> *Id.* at 2907-7 to -8.

<sup>413</sup> *Id.* at 2907-9 to -10.

<sup>414</sup> *Id.* at 2907-8 to -9.



146 Adopting Release, "access can exist only by reason of the offeree's position with respect to the issuer. Position means an employment or family relationship or economic bargaining power that enables an offeree to obtain information from the issuer in order to evaluate the merits and risks of the investment."<sup>415</sup>

(5) *Manner of offering.* Rule 146 contained an express prohibition against general advertising and solicitation.<sup>416</sup>

(6) *Limitation on resale.* Rule 146 retained the well-established requirement of limited resales of securities acquired in private placements to assure against redistribution.<sup>417</sup>

---

<sup>415</sup> *Id.* at 2907-7.

<sup>416</sup> See Rule 146 Adopting Release, *supra* note 410, at 2907-7.

The Rule prohibits the issuer or any person acting on its behalf from offering or selling the securities through any form of general advertising or general solicitation including, but not limited to, advertisements or other communication in newspapers, magazines, or other media; broadcasts on radio or television, seminars or promotional meetings or any letter, circular, or other written communication.

The prohibition . . . does not necessarily mean that there can be no meetings or written communication. It means that any such meetings can involve only offerees . . . who can satisfy the conditions . . . and that any written material can be distributed only to offerees who satisfy the conditions.

*Id.* For an earlier reference to the prohibition on public advertising as an element of the section 4(2) exemption, see Securities Act Release No. 4552, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 (Nov. 6, 1992). For discussion of the successor prohibition on general solicitation and advertising contained in Regulation D under the Securities Act, see Bryn Vaaler, *Financing a Small Business in Mississippi: A Practitioner's Guide to Federal and State Securities Exemptions (Part I)*, 63 MISS. L.J. 129, 204-13 (1993) [hereinafter *Financing a Small Business (Part I)*].

<sup>417</sup> See Rule 146 Adopting Release, *supra* note 410, at 2907-10.

The Rule also provides that the issuer and any person acting on its behalf must take reasonable care to assure that the purchasers are not underwriters. Such reasonable care shall include but is not necessarily limited to (1) making reasonable inquiry to determine if the purchaser is purchasing for his own account or on behalf of others; (2) placing a legend on the certificates or other documents evidencing the securities indicating that they were not registered and setting forth or referring to the restrictions on transferability and sale; (3) issuing stop transfer instructions to the restrictions on transferability and appropriate notation in the issuer's records if the issuer transfers its own securities; and (4) . . . obtaining a written agreement from the purchaser that the securities will not be resold without registration or exemption therefrom.

*Id.* For earlier discussion of this requirement as an element of the § 4(2) exemption, see Securities Act Release No. 4552, *supra* note 416, at 2920-22. For discussion of the



(7) *Form filing.* Rule 146 also required timely filing of a notice on Form 146 as a condition to availability of the safe harbor.

Adoption of Rule 146 was a substantial step forward in terms of certainty under the section 4(2) exemption. The rule had an immediate impact on judicial decisions interpreting the statutory exemption.<sup>418</sup> However, Rule 146 was not a complete success. Practitioners and commentators criticized it as being overly restrictive.<sup>419</sup> In 1982, the SEC adopted Regulation D under the Securities Act, Rule 506 of which replaced Rule 146 as the safe harbor rule under section 4(2).<sup>420</sup>

## 2. *Rule 506 and the Statutory Section 4(2) Exemption: A Practical Evaluation*

Rule 506 made a number of very significant changes to the safe harbor. One of the most notable was the elimination of offeree qualification as a separate, explicit condition.<sup>421</sup> Rule 506 imposes its sophistication requirement only on purchasers,

---

successor limitations on resale contained in Regulation D under the Securities Act, see *Financing a Small Business (Part I)*, *supra* note 416, at 213-20.

<sup>418</sup> See, e.g., *Mary S. Krech Trust v. Lakes Apartments*, 642 F.2d 98, 101-03 (5th Cir. 1981); *Doran*, 545 F.2d at 906; *Woolf*, 515 F.2d at 612.

<sup>419</sup> See, e.g., Rutheford B. Campbell, Jr., *The Plight of Small Issuers Under the Securities Act of 1933: Practical Foreclosure from the Capital Market*, 1977 DUKE L.J. 1139, 1143 (failed to remove many major ambiguities); Douglas S. Perry, Comment, *Private Placement Exemptions Outside SEC Rule 146*, 25 EMORY L.J. 899, 933 (1976) ("rigorous"); Stanley Schwartz, Jr., *The Private Offering Exemption — Recent Developments*, 37 OHIO ST. L.J. 1, 29 (1976) (not coming to grips with needs of venture capital formation); Robert A. Kessler, *Private Placement Rules 146 and 240 — Safe Harbor?*, 44 FORDHAM L. REVIEW. 37, 63 (1975) (fails to achieve its purpose of reducing uncertainty); H. David Heumann, *Is SEC Rule 146 Too Subjective to Provide the Needed Predictability in Private Offerings?*, 55 NEB. L. REV. 1, 24 (1975) ("unworkable"); Tom A. Alberg & Martin E. Lybecker, *New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities*, 74 COLUM. L. REV. 622, 623 (1974) (small increase in certainty in exchange for substantial narrowing of criteria); Homer A. Kripke, *SEC Rule 146: A "Major Blunder"*, N.Y.L.J., July 5, 1974, at 1, col. 3. ("major blunder").

<sup>420</sup> For a comprehensive discussion of Regulation D and the Rule 506 safe harbor, see *Financing a Small Business (Part I)*, *supra* note 416, at 142-226.

<sup>421</sup> See Adoption of Regulation D, Securities Act Release No. 6389, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106, at 84,919 (Mar. 8, 1982) [hereinafter Regulation D Adopting Release].

and imposes no ability-to-bear-risk requirement like that in Rule 146.<sup>422</sup> Qualification of offerees remains a relevant consideration under Rule 506 in determining whether the issuer has complied with the prohibition on general solicitation and advertising which is the same as under Rule 146.<sup>423</sup> The prohibition on general solicitation and advertising, however, deals with the general manner in which the issuer makes the offering, not the qualifications of each actual offeree.<sup>424</sup> Under Rule 506, an issuer that markets an offering in compliance with the prohibition on general solicitation and advertising will not necessarily lose the exemption because an offer is made by mistake to an inappropriate offeree.<sup>425</sup> Even one bad offer could theoretically destroy the exemption under some prior section 4(2) interpretations.<sup>426</sup>

---

<sup>422</sup> *Id.*; see also *Financing a Small Business (Part I)*, *supra* note 416, at 159-60.

<sup>423</sup> "The notion of a qualified offeree in this context is expressed in terms of a person who, because of a pre-existing relationship with the issuer or persons acting on its behalf, has given the offeror a reasonable basis for believing that he is a sophisticated investor." HICKS, *supra* note 381, § 11.11[2][a][i]. For discussion of the Regulation D prohibition on general solicitation and advertising and the essential role played by pre-existing relationships between the issuer and offerees, see *Financing a Small Business (Part I)*, *supra* note 416, at 204-13.

<sup>424</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 207.

<sup>425</sup> "Thus, for example, if an offering is structured so that only persons with whom the issuer and its agents have had a prior relationship are solicited, the fact that one potential investor with whom there is no such prior relationship is called may not necessarily result in a general solicitation." Securities Act Release No. 6825, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,404, at 80,047 (Mar. 14, 1989) [hereinafter 1989 Regulation D Amendment Release] [footnotes omitted]; see *Financing a Small Business (Part I)*, *supra* note 416, at 224.

<sup>426</sup> See *Henderson v. Hayden, Stone Inc.*, 461 F.2d 1069, 1071-72 (5th Cir. 1972) (indicating that issuer's burden of proof as to requirements of exception must be met with respect to each offeree); see also *Morgenstern*, *supra* note 381, at 263; *Nimkin*, *supra* note 381, at 869. *But cf. Schneider*, *supra* note 381, at 876 (stating "[t]he better view is that qualification of the offeree is not an independent requirement of a proper private placement"). Whether sophistication is a separate requirement of the statutory § 4(2) exemption and whether lack of sophistication on the part of one offeree destroys the entire exemption (even if the offeree does not purchase) are both issues that have received hopelessly varied and confusing treatment by courts. For an in-depth discussion of the different treatment given these issues in the various federal circuits, see HICKS, *supra* note 381, § 11.08[2][a]. Although some Fifth Circuit opinions indicate that sophistication may not be a required factor in some circumstances, there is no clear authority that eliminates it definitively as an element. See, e.g., *Doran*, 545 F.2d at 902

Perhaps the most important development in the Rule 506 safe harbor was the incorporation of the Regulation D "accredited investor" concept.<sup>427</sup> Accredited investors, as defined in Rule 501(a)(1), consist of certain categories of investors who are basically attributed by rule with the section 4(2) ability to "fend for themselves." The accredited investor definition has significance under Rule 506 in three respects:

(1) *The exemption is not conditioned upon delivery of any particular information to accredited investors, whereas each non-accredited investor must receive the information specified in Rule 502 of Regulation D as a condition to availability of the exemption.*<sup>428</sup> In terms of Rule 146 and the statutory exemp-

---

n.10; Swenson v. Engelstad, 626 F.2d 421, 426 n.12 (5th Cir. 1980); Weprin v. Peterson, 736 F. Supp. 1124, 1128-29 (N.D. Ga. 1988). See also HICKS, *supra* note 381, § 11.08[2][a][iv] (stating that sophistication is of limited significance in Fifth Circuit).

The characteristics required to support a finding of section 4(2) sophistication have varied in the case law, but have usually included some combination of higher education, occupation, business experience, investment experience, relationship with the issuer and other investors or economic bargaining power. Courts have found general business sophistication and investment acumen to suffice even where knowledge or experience in the particular field of the issuer was lacking. For example, in *Barrett v. Triangle Mining Corp.*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,438, at 99,211 (S.D.N.Y. Feb. 2, 1976), a Harvard College degree and general business experience were sufficient despite a finding that the offeree had no familiarity with the particular type of business involved. In one federal district case, the court found that two doctors investing in oil and gas limited partnerships were sophisticated based upon such factors as their being successful doctors and making a financial success of their hospital, negotiating the terms of the private placement and employing an attorney. *Bayoud v. Ballard*, 404 F. Supp. 417, 423-24 (N.D. Tex. 1975). A history of similar investments, however, is frequently cited, although it is presumably no assurance of sophistication if a lack of competence is shown. See *Doran*, 545 F.2d at 902; *Chapman v. Dunn*, 414 F.2d 153, 159-60 (6th Cir. 1969); *Mason v. Marshall*, 412 F. Supp. 294, 297-99 (N. D. Tex. 1974). For an in-depth discussion of the case law defining the attributes of § 4(2) sophistication, see HICKS, *supra* note 381, § 11.08[2][b].

<sup>427</sup> For a comprehensive discussion of the accredited investor concept and its role under Rule 506 and the other Regulation D exemptions, see *Financing a Small Business (Part I)*, *supra* note 416, at 161-73.

<sup>428</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 180-81. Section 4(2) and Rule 506 provide exemption from the registration and prospectus delivery requirements of the Securities Act. They do not, of course, provide an exemption from the antifraud provisions of the federal securities laws.

Even in a transaction limited to accredited investors . . . the prudent counsel and issuer are well advised to provide written materials to comply with the *antifraud* provisions of the state and federal securities laws, particularly



tion, accredited investors under Rule 506 are deemed to have "access" (which makes actual delivery of information unnecessary for the exemption). No one beyond the accredited investor categories, however, is deemed to have access in the safe harbor. They all must actually receive the defined disclosure equivalent of a registration statement.<sup>429</sup> In other words, the Rule 506 safe harbor embodies the access alternative to actual disclosure in the accredited investor categories but otherwise eliminates it from the safe harbor, thus avoiding one of the most difficult aspects of the Rule 146 safe harbor and the statutory exemption: determining which investors have access and which do not.<sup>430</sup>

---

providing information in sensitive areas such as conflicts of interest, source and use of funds, and compensation and other ownership and benefits to management and promoters. In many transactions with sophisticated buyers, additional information may be requested by the buyer even beyond that found in a registration statement, including projections and other similar information.

Morgenstern, *supra* note 381, at 269 n.66; see also *Financing a Small Business (Part I)*, *supra* note 416, at 147 n.52; HICKS, *supra* note 381, § 11.15[2].

<sup>429</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 161.

<sup>430</sup> The courts have generally construed "access" narrowly, consistent with the view expressed by the SEC in connection with adoption of Rule 146 that "access can exist only by reason of the offeree's position with respect to the issuer . . . [and that] [p]osition means an employment or family relationship or economic bargaining power that enables an offeree to obtain information from the issuer in order to evaluate the merits and risks of the investment." Rule 146 Adopting Release, *supra* note 410, at 2907-3. Absent provision of disclosure, it would appear that the necessary relationship for access exists only in a few limited circumstances. See, e.g., *Ralston Purina*, 346 U.S. at 125-26 (offering made to executive managers of issuer); *Fuller v. Dilbert*, 244 F. Supp. 196, 212 (S.D.N.Y. 1965) (offering made to major shareholders of family-controlled corporation); *Value Line Fund, Inc. v. Marcus*, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,523, at 94,953-74 (S.D.N.Y. 1965) (an offering made to institutional or professional venture capital investors, managers of which can exert significant economic leverage).

Access must be determined based on the facts and circumstances of each particular offering, because even an investor whose position generally provides access to the informational equivalent of a registration statement may be an outsider as to a particular transaction. *Doran*, 545 F.2d at 906 n.18. In *General Life Inv. Co. v. Shamburger*, 546 F.2d 774, 782 (8th Cir. 1976), for example, a member of the board of directors and attorney for the issuer and related corporations was found not to have sufficient access where he had only limited information with respect to the transaction in question. By the same token, an investor may be a transactional insider with respect to a particular offering even though such investor does not generally have access to the



(2) *Accredited investors are not counted in the Rule 506 numerical limitation on purchasers.*<sup>431</sup> The Rule 506 safe harbor, like that in Rule 146, includes a limit of thirty-five purchasers. However, accredited investors do not count toward the thirty-five purchasers. Subject to the prohibition on general solicitation and advertising, an issuer may sell under the Rule 506 safe harbor to a theoretically limitless number of accredited investors.

(3) *Accredited investors are deemed to meet the Rule 506 sophistication requirement.*<sup>432</sup> Each purchaser who is not an accredited investor, however, must have (or the issuer must reasonably believe such purchaser to have), either alone or with his purchaser representative, such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment.<sup>433</sup> Rule 506 thus eliminates the difficulties and ambiguities involved in

---

informational equivalent of a registration statement. In *Van Dyke v. Coburn Enterprises, Inc.*, 873 F.2d 1094, 1098 (8th Cir. 1989), an offeree was found to have access based on its knowledge of the issuer as an artichoke supplier.

Among those relationships, standing alone, which have failed the access test see generally: *Ralston Purina*, 346 U.S. at 125 (key employee); *SEC v. Spence & Green Chem. Co.*, 612 F.2d 896, 902 (5th Cir. 1980) (shareholder); *Robinette & Co.*, 42 S.E.C. 199, 201 (1964) (shareholder); *Continental Tobacco*, 463 F.2d at 158 (relatives, friends, neighbors and associates of insiders and promoter). For additional discussion of access under the statutory exemption, see HICKS, *supra* note 381, § 11.08[3][c].

Even the most cursory review of the case law interpreting access under § 4(2) demonstrates what a dramatic development it was in Regulation D to create a safe harbor in which access was in effect presumed with respect to categories of investors as broad as those in the accredited investor definition.

<sup>431</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 175-76. Outside the safe harbor, there simply is no number test that will guarantee that an offering is nonpublic. See *supra* note 387 and accompanying text. In dictum, the *Ralston Purina* decision indicated that even an offering made to one person could be "public." *Ralston Purina*, 346 U.S. at 125 n.11; cf. *Hirtenstein v. Tenney*, 252 F. Supp. 827, 830 (S.D.N.Y. 1966) (denying defendant's motion for summary judgment where apparently only one offeree involved); *Meadow Brook National Bank v. Levine*, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,496, at 94,869-71 (N.Y. Sup. Ct. 1965) (concluding that transfer of securities to one person was not necessarily nonpublic). For an analysis of § 4(2) case law based on the number of offerees and purchasers involved, see HICKS, *supra* note 381, § 11.06[2].

<sup>432</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 160.

<sup>433</sup> *Id.*

subjective, case-by-case inquiry as to sophistication for accredited investors. It does so even though the accredited investor categories seem more oriented toward assessing ability to bear risk than sophistication as an investor.

The power of the Rule 506 safe harbor is most evident when one considers the simplicity of an offering made exclusively to accredited investors. By making an offering exclusively to accredited investors (or persons the issuer reasonably believes to be accredited investors) under Rule 506, an issuer may be assured of a section 4(2) exemption regardless of: (1) the offering size; (2) how much or little disclosure is actually provided; (3) the number of purchasers; and (4) the actual investment sophistication of the purchasers. The issuer also does not have to worry about the sophistication of each and every offeree. The issuer is simply required to comply with the prohibition on general solicitation and advertising and take appropriate steps to assure against redistribution.<sup>434</sup>

Amendments to Regulation D and Rule 506 since its adoption in 1982 have further liberalized the safe harbor. The SEC has broadened and clarified the already broad accredited investor categories.<sup>435</sup> The SEC also eliminated the mandatory Form D filing as a condition to exemption availability, made the mandatory steps to assure against redistribution illustrative only and added Rule 508 which prevents loss of the exemption due to certain insignificant deviations.<sup>436</sup>

One of the most important *practical* needs of small business financing is for a securities exemption that is sufficiently certain for planning purposes, but not conditioned on delivery of prohibitively expensive disclosure. Rule 506 meets this need head on. The liberally defined accredited investor categories of Regulation D cover an ample segment of the investor market for small business issues. By offering exclusively to such investors, the issuer is assured of the section 4(2) exemption without

---

<sup>434</sup> For a comprehensive discussion of these requirements of Rule 506, which are essentially a continuation of the Rule 146 requirements, see *Financing a Small Business (Part I)*, *supra* note 416, at 204-20.

<sup>435</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 161-73.

<sup>436</sup> See *id.* at 223-26.

having to worry about the offeree sophistication problem and without having to guess at the "access" riddle.

The SEC provided further for this essential need of small business in the Rule 504 and Rule 701 exemptions adopted pursuant to section 3(b) of the Securities Act.<sup>437</sup> The Rule 504 exemption under Regulation D covers offerings by nonpublic issuers up to \$1,000,000. As currently in effect, the Rule 504 exemption has no information delivery, access-to-information, sophistication or other requirements or conditions, regardless of the accredited status of investors. The SEC adopted Rule 701 in 1987 to provide nonpublic issuers with an exemption that is not conditioned on delivery of expensive information or access to information for offers and sales to employees and others under compensatory plans and contracts.

Together, the Rule 506 safe harbor, Rule 504 and Rule 701 have gone a long way toward supplanting the role of the statutory section 4(2) exemption for small business financing.<sup>438</sup> When small business issuers consult experienced securities practitioners in advance, proposed transactions are modified to fit these rules (e.g., by limiting the offering to accredited investors or, if not possible, by staying under the Rule 504 ceiling).<sup>439</sup> The primary recurring reason why a

---

<sup>437</sup> For a comprehensive discussion of the Rule 504 exemption in Regulation D, see *Financing a Small Business (Part I)*, *supra* note 416, at 150-57. For a comprehensive discussion of the Rule 701 exemption, see *infra* notes 441-516 and accompanying text.

<sup>438</sup> A rough measure of the extent to which securities practitioners rely on Regulation D and Rule 701 in their work to the exclusion of the statutory exemption, may be seen by browsing through the coursebook distributed in connection with the Practising Law Institute's annual continuing legal education program entitled "Private Placements." Notwithstanding the name of the program, the 1993 coursebook contains *literally* no substantive discussion of legal developments under the statutory exemption itself. The entire text is devoted to Regulation D, Rule 701 and other alternatives to the § 4(2) exemption. See *Private Placements 1993* PLI Corporate Law & Practice Course Handbook Series No. B-811 (1993).

<sup>439</sup> See, e.g., Morgenstern, *supra* note 381, at 262-65 (model letter to corporate client preparing for private placement advises reliance on Rule 506 instead of "vague," "uncertain" and "murky" § 4(2)).

The § 4(2) exemption and the Rule 506 safe harbor are both subject to the SEC's integration doctrine. See *Financing a Small Business (Part I)*, *supra* note 416, at 187-204. The exemptions apply to "offerings," not to individual offers and sales. In order for any particular offer or sale to be exempt under § 4(2) or the Rule 506 safe harbor,



small business issuer intentionally offers securities in reliance on the section 4(2) exemption alone is because it is offering in excess of the Rule 504 ceiling, in a transaction not covered by Rule 701 in which production of expensive disclosure is not feasible *and* sales to non-accredited investors cannot be avoided. In these cases, issuers and their counsel must deal directly with the fundamental ambiguities of the statutory exemption (primarily the sophistication and access-to-information problems) and consider them in light of their burden of proving the availability of the exemption. Except in a few relatively clear cases, such as offerings made exclusively to upper-echelon managers of the issuer or offerings made exclusively to professional venture capital investors and their affiliates,<sup>440</sup> judicial interpretations of the statutory exemption provide little clarity.

*B. Rule 701: Exemption for Compensatory Plans and Contracts*

*1. General*

*a. Compensatory Transactions, Nonpublic Companies and the Federal Securities Law*

In addition to financing through securities issuances, small businesses may also use their securities to compensate employees and other personnel. Securities-based plans or arrangements often constitute an essential part of the compensation structure of nonpublic companies, especially start-up ventures in which the ability to share in equity appreciation is often the most powerful inducement and incentive available to attract and motivate employees.

---

such offer or sale (and all other offers or sales which are part of the same "offering" of securities) must meet all applicable conditions of those rules. The five-factor test for determination of which offers and sales are considered part of the same offering for this purpose under § 4(2) was enunciated in Securities Act Release No. 4552, *supra* note 416.

<sup>440</sup> For a description of the types of transactions that practitioners do and do not advise to be carried out in reliance on the statutory exemption, see HICKS, *supra* note 381, § 11.14.



Offering securities to employees in compliance with the federal securities laws, however, has frequently posed problems for nonpublic companies.<sup>441</sup> A relatively low-cost Securities Act registration procedure (using Securities Act Form S-8)<sup>442</sup> is available to public companies for securities-based compensatory plans, but no comparable procedure is available to nonpublic companies.<sup>443</sup> For a nonpublic company, Securities Act registration entails essentially the same costly and time-consuming procedure whether it involves sales under a compensatory benefit plan or in an underwriting or other financing transaction. In either case, the issuer must prepare extensive disclosure documentation, submit to SEC review, maintain the accuracy of the disclosure documentation throughout the offering period (which may be years under a compensatory benefit plan) and become subject to the periodic reporting requirements under the Exchange Act.<sup>444</sup> Consequently, registration of securities offerings pursuant to compensatory plans or contracts is almost never a realistic alternative for nonpublic companies.<sup>445</sup>

---

<sup>441</sup> Where an employer issues its own securities to employees as a bonus or reward for services performed with no contractual commitment on the part of the employee, the transaction may not constitute a "sale" within the meaning of § 2(3) of the Act. Consequently, the § 5 registration requirement would not apply. See HICKS, *supra* note 381, § 8.03[1]; 2 LOSS & SELIGMAN, *supra* note 381, at 1088. However, where an employer issues securities as an inducement or bargained-for compensation, a sale exists and the issuer must comply with § 5 or an available exemption. *Id.* The no-sale theory offers relief from § 5 in only a very few types of employee issuances, and application of the theory is complex and uncertain. See generally Securities Act Release No. 6281, 1 Fed. Sec. L. Rep. (CCH) ¶ 1052, at 2073-30 to -31 (Jan. 15, 1981); Securities Act Release No. 6188, 1 Fed. Sec. C. Rep. (CCH) ¶ 1051 (Feb. 1, 1980); Subcommittee on Executive Compensation of the Committee on Employment Benefits and Executive Compensation of the Business Law Section, American Bar Association, *Executive Compensation: A 1987 Road Map for the Corporate Advisor*, 43 BUS. LAW. 185 (1987); 2 LOSS & SELIGMAN, *supra* note 381, at 1088-89, 1102-07.

<sup>442</sup> 17 C.F.R. § 239.16b (1993).

<sup>443</sup> *Id.* (General Instruction A(1)).

<sup>444</sup> Section 15(d) of the Exchange Act imposes the obligation to file periodic reports on all issuers that have had a Securities Act registration become effective. 15 U.S.C. § 78o(d) (1988); see *Financing a Small Business (Part I)*, *supra* note 416, at 151 n.66.

<sup>445</sup> Accord Securities Act Release No. 6683, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,054, at 88,405 (Jan. 16, 1987); HICKS, *supra* note 381, § 8.03[1].

A number of transactional exemptions from Securities Act registration are potentially available to nonpublic companies offering securities pursuant to compensatory plans or contracts, including the limited offering exemption in Regulation A<sup>446</sup> under the Securities Act, the limited and nonpublic exemptions in Regulation D and the section 4(2) private placement exemption. None of these exemptions were designed specifically for compensatory offerings. Consequently, they do not work ideally for a broad range of compensatory uses, due to restrictions involving the number or sophistication of purchasers, prohibitively expensive disclosure requirements or other problems.<sup>447</sup>

*b. Adoption of Rule 701*

The SEC proposed Rule 701 in January 1987 in order to meet the need for a completely separate compensation exemption which would not be restricted with respect to the number or qualifications of eligible purchasers and would not be conditioned upon delivery of expensive disclosure documentation.<sup>448</sup> The rule was finalized in April 1988 with an effective date of May 20, 1988.<sup>449</sup>

Like Regulation A and the Rule 504 and Rule 505 exemptions in Regulation D, Rule 701 was promulgated by the SEC

---

<sup>446</sup> For a brief description of the Regulation A exemption, see *Financing a Small Business (Part I)*, *supra* note 416, at 143 n.32.

<sup>447</sup> Regulation A and, later, Rule 504 were the most useful exemptions for nonpublic issuers wishing to offer securities to a broad range of employees. Neither Regulation A nor Rule 504 limits the number of purchasers or requires that purchasers meet any threshold of sophistication. Rule 504 offers the additional advantage of not being conditioned on delivery of costly disclosure. Use of the Regulation A and Rule 504 exemptions for compensatory transactions, however, reduces their already limited availability for capital formation. See HICKS, *supra* note 381, § 8.03[1].

<sup>448</sup> See Securities Act Release No. 6683, *supra* note 445, at 89,405.

<sup>449</sup> See Adoption of Rule 701, Securities Act Release No. 6768, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,231, at 89,062 (Apr. 14, 1988) [hereinafter Rule 701 Adopting Release]. See generally HICKS, *supra* note 381, § 8.03; RICHARD R. PLUMRIDGE, ET AL., *Rule 701: Securities Act of 1933 Exemption for Issuances under Compensatory Benefit Plans*, in *Private Placements 1993* (PLI Corporate Law & Practice Course Handbook Series Number B-811, 1993).

pursuant to section 3(b) of the Securities Act.<sup>450</sup> Since section 3(b) is not itself an exemption from registration, but rather an empowering provision giving the SEC authority to promulgate rules creating exemptions, Rule 701 is not a safe harbor within a statutory exemption (as, for example, Rule 506 is a safe harbor within the section 4(2) private placement exemption).<sup>451</sup> Consequently, precise compliance with all the terms and conditions of the rule is required to ensure availability of the intended exemption.

### c. *Form S-8 Revisions*

Before adoption of Rule 701, some practitioners had hoped that the proposed new exemption would apply to compensatory transactions by public issuers as well, in order to eliminate the need for Form S-8 registrations.<sup>452</sup> Instead, the SEC undertook an extensive revision of Form S-8 to streamline its use, reduce its costs and expand its availability. The Form S-8 revisions were finalized in June 1990.<sup>453</sup>

The revised Form S-8 serves the following purposes: eliminates the traditional prospectus, allowing issuers to use plan documents in its place; is available for transactions under individually negotiated written compensatory contracts as well

---

<sup>450</sup> 15 U.S.C. § 77c(b) (1988). Section 3(b) of the Securities Act authorizes the SEC to adopt exemptions by rule covering any class of securities:

[I]f it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds \$5,000,000.

*Id.*

<sup>451</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 147-48.

<sup>452</sup> See, e.g., Jesse M. Brill, *Your S-8 and Other Matters Requiring Your Attention*, THE CORPORATE COUNSEL, Nov.-Dec. 1986, at 1, 3; Jesse M. Brill, *Rule 701 — A Significant New Registration Exemption for Employee Stock Plans of Nonpublic Issuers*, 13 THE CORPORATE COUNSEL, Mar.-Apr. 1988 at 1, 2.

<sup>453</sup> See Revision to Form S-8, Securities Act Release No. 6867, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,605 (June 6, 1990) [hereinafter Form S-8 Revision Release].



as compensatory "plans,"<sup>454</sup> is available for sales of stock to consultants and advisors who render bona fide services to the issuer (other than in connection with capital-raising transactions);<sup>455</sup> becomes effective automatically upon filing instead of requiring a twenty-day waiting period; and becomes available to an issuer immediately after the issuer completes its initial public offering instead of requiring a ninety-day waiting period.<sup>456</sup>

## 2. *Exemption for Compensatory Plans and Contracts*

### a. *Availability of the Exemption*

The exemption covers only offers and sales by a nonpublic issuer of its own securities: (1) pursuant to a written compensatory benefit plan established by that issuer (or its parent company or majority-owned subsidiaries) for the participation of its employees, directors, general partners, officers, consultants, advisers, or trustees (where the issuer is a business trust); or (2) pursuant to a written contract relating to the compensation of such persons.<sup>457</sup> Companies subject to the

---

<sup>454</sup> In this respect, the scope of revised Form S-8 now mirrors that of Rule 701. See *infra* notes 465-70 and accompanying text.

<sup>455</sup> 17 C.F.R. § 239.16b (1993) (General Instruction A(1)(a)). In this respect, too, revised Form S-8 now parallels Rule 701 in coverage. See *infra* note 465-70 and accompanying text.

<sup>456</sup> 17 C.F.R. § 239.16b (1993) (General Instructions A(1)(a) & D).

<sup>457</sup> *Id.* § 230.701(b)(1). Like the exemptions of Regulation D, the § 4(2) private placement exemption and the Rule 147 intrastate exemption, Rule 701 is available to issuers only. It is not available for resale transactions. 17 C.F.R. § 230.701 (Preliminary Note 4) (1992). In *Marshall's Finance Ltd. and Lasser Marshall, Inc.*, 1993 SEC No-Act. LEXIS 778 (June 15, 1993), however, the SEC staff indicated that an employee share trust affiliated with an English company could rely on Rule 701 in offering and selling shares of the English company to U.S. employees. Counsel for Marshall's Finance also requested confirmation from the staff that periodic resales by U.S. employees back to the share trust would be exempt under the so-called "§ 4(1½)" exemption for private resales. See *Financing a Small Business (Part I)*, *supra* note 416, at 220. The staff refused to express a view on the "§ 4(1½)" exemption, but indicated that "sales by the U.S. employees to the [share trust] of Ordinary Shares purchased pursuant to the employee benefit plans . . . will be exempt . . . by virtue of Rule 701." This last aberration appears to be purely the result of the staff's desire to permit an otherwise unobjectionable compensation arrangement to proceed while maintaining a



periodic reporting requirements pursuant to section 13 or 15(d) of the Exchange Act or investment companies subject to the Investment Company Act of 1940 may not rely on the exemption.<sup>458</sup>

*b. Compensatory Purpose*

The exemption is intended to cover only bona fide compensatory transactions. Transactions for capital-raising or other

---

rigid no-comment policy on "§ 4(1½)."

<sup>458</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 151-52. A reporting company that properly suspends or eliminates its reporting obligations under § 13 or 15(d) will once again be eligible for Rule 701. See *New City Communications, Inc.*, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,892, at 78,470 (Oct. 7, 1988).

An issuer that is unable to suspend or eliminate its Exchange Act reporting obligations under § 15(d) due to shareholder or asset levels exceeding those necessary for suspension under Exchange Act Rule 12h-3, will not be able to avail itself of Rule 701. See 17 C.F.R. § 240.12h-3 (1993). In *Peoria Journal Star, Inc.*, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,893 (Oct. 7, 1988), a company registered the sale of its common stock to an ESOP which thereafter offered plan interests to employees through a Form S-8 registration. The company and the ESOP were thus both subject to Exchange Act reporting obligations under § 15(d). Following adoption of Rule 701, the company and the ESOP sought SEC approval to suspend § 15(d) reporting in order to rely on Rule 701 in the future. The company was eligible to suspend its Exchange Act reporting under Rule 12h-3 (since it had fewer than 300 shareholders), but the plan was not (since it had over 300 participants and over \$5,000,000 in assets). The SEC refused to grant special dispensation to the ESOP even though it would not have been subject to § 15(d) had Rule 701 been in effect at the time the ESOP was created.

However, in *Starbucks Corp.*, 1992 SEC No-Act. LEXIS 483 (Apr. 2, 1992), the SEC affirmed that a nonreporting issuer that had adopted a company-wide option plan could grant non-transferable stock options to more than 500 employees without being required to register under § 12(g) of the Exchange Act, thereby permitting the issuer to rely on Rule 701 for option grants under the plan. The plan conditioned exercise of the options on registration under the Securities Act of the underlying shares of common stock.

Foreign issuers submitting home country reports under § 12g3-2(b) of the Exchange Act may rely on Rule 701. Rule 701 Adopting Release, *supra* note 449, at 89,062 n.3; see also 17 C.F.R. § 240.12-g3-2(b) (1993). Foreign banks may be allowed to offer their shares to U.S. employees pursuant to Rule 701 despite possible "investment company" status. See *Union Bank of Finland Ltd.*, 1990 SEC No-Act. LEXIS 958 (Mar. 14, 1990); *Canadian Imperial Bank of Commerce*, 1989 SEC No-Act. LEXIS 774 (Jan. 18, 1989).

purposes are not covered, even if conducted in a manner which appears to come within the scope of the exemption.<sup>459</sup>

The rule expressly excludes issuances to consultants or advisers for services in connection with a financing.<sup>460</sup> Beyond this limitation, however, the scope of consulting services eligible for compensatory issuances pursuant to Rule 701 is broad. For example, golf professionals who entered into participation agreements with the issuer and received common stock as compensation for ordering merchandise from the issuer have been considered eligible consultants or advisers for purposes of Rule 701.<sup>461</sup> Other types of independent, non-employee representatives or agents have also been found eligible for Rule 701 offerings.<sup>462</sup>

The purpose requirement may preclude the use of the exemption for transactions which are not purely compensatory, such as early stage issuances to founders in exchange for a combination of services, product rights and similar contributions. The SEC, however, has permitted reliance on Rule 701 in connection with ESOP-acquisition transactions despite the

---

<sup>459</sup> In *SCI Financial Group*, the SEC staff indicated that an issuer and its counsel will be in the best position to assess whether a proposed plan constitutes a compensatory arrangement or a capital raising transaction. SCI was the parent corporation of a registered broker-dealer that had an established ESOP. SCI proposed to offer qualified employees the opportunity to acquire stock through the ESOP and to provide financial assistance in the form of below-market loans or guarantees of bank loans. The SEC refused to issue an interpretive opinion to the effect that Rule 701 would be available for the transaction, but indicated that:

[A]s a general matter it is our view that the items highlighted in your letter dealing with limitations on the number and types of participants, providing financial assistance for the purchase of securities and establishing purchase prices for nonpublic companies on the basis of previous recent sales, would not in and of themselves cause a compensatory plan to be deemed a capital-raising device.

SCI Financial Group, Inc., 1988 SEC No-Act. LEXIS 1483, at \*1 (Nov. 14, 1988).

<sup>460</sup> 17 C.F.R. § 230.701(b)(1) (1993); see also Alan W. Peryam, 1988 SEC No-Act. LEXIS 781 (June 16, 1988).

<sup>461</sup> Golfpro, Inc., 1989 SEC No-Act. LEXIS 981 (Oct. 3, 1989).

<sup>462</sup> See Herff Jones, Inc., 1990 SEC No-Act. LEXIS 1269 (Nov. 13, 1990) (independent exclusive sales representatives receiving shares under issuer's restricted share purchase plan); Exceptional Producers Holding Co., SEC No-Action Letter, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,354, at 79,305 (Aug. 17, 1989) (independent insurance agents selling policies of affiliate of issuer).

capital-raising aspects of such transactions. In *Professional Food-Service Management, Inc.*,<sup>463</sup> for example, the SEC staff indicated that Rule 701 would be available with respect to (a) a special one-time election whereby participants in a company's profit sharing plan are given the opportunity to convert their existing accounts into interests in a newly established ESOP and (b) employee acquisitions of interests in the ESOP through 401(k) salary reduction contributions.<sup>464</sup>

*c. Definition of "Compensatory Benefit Plan"*

A "compensatory benefit plan" is defined in Rule 701 as "any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, pension or similar plan."<sup>465</sup> The exemption specifies no formal requirements other than that the plan, like the contract, must be in writing.<sup>466</sup>

What constitutes a "plan" may not always be clear. For example, the board of directors of a nonpublic company may authorize the issuance of stock to an officer upon achievement of certain goals. The authorization takes the form of a set of resolutions contained in the board minutes. The resolutions may constitute an adequate writing, but does a one-person, one-time authorization constitute a "plan" in a meaningful sense of the word? The SEC has, in other contexts, indicated that it does not.<sup>467</sup> If Rule 701 availability is important in such a case, the issuer will have to devise an appropriate compensatory contract.

A compensatory benefit plan may provide for the participation of persons other than those listed in Rule 701. Offers and sales under the plan to listed persons may be made in reliance

---

<sup>463</sup> SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,968, at 78,831 (Feb. 1, 1989).

<sup>464</sup> *Id.*; see *Marshalls Finance Ltd.*, 1990 SEC No-Act. LEXIS 1277 (Nov. 27, 1990).

<sup>465</sup> 17 C.F.R. § 230.701(b)(2) (1993).

<sup>466</sup> *Id.* § 230.701(b)(1).

<sup>467</sup> See, e.g., Exchange Act Release No. 18114, 4 Fed. Sec. L. Rep. (CCH) ¶ 26,062, at 19,063-69, Question 110 (Sept. 23, 1981) (stating one-time bonus share grant in individual employment agreement does not constitute "plan" within meaning of Exchange Act Rule 16b-3 as then in effect).



on Rule 701 while offers and sales to persons not listed must be made pursuant to another available Securities Act exemption.<sup>468</sup> However, a compensatory benefit plan which permits a former employee to exercise options (initially granted and vested during the course of employment) after termination of employment would satisfy the provisions of Rule 701, and Rule 701 would presumably be available (subject to compliance with all other conditions) for the exercise of such options by the former employee.<sup>469</sup> A similar rule with respect to former employees has been included in the instructions regarding availability of revised Form S-8.<sup>470</sup>

*d. Applicability to Pre-March 20, 1988 Offers and Post-IPO Sales*

Rule 701 expressly provides that an eligible issuer may rely upon it with respect to sales made after its May 20, 1988 effective date, even if such sales are made pursuant to offers initiated before such date (so long as the offers would have been in compliance with Rule 701 had it then been in effect).<sup>471</sup> For example, a nonpublic company that adopted a written employee stock option plan (ESOP) in 1986 may rely on the Rule 701 exemption to cover the exercise of options after May 20, 1988, even if the options were granted before May 20, 1988 (assuming the plan and the options would otherwise have qualified for Rule 701 coverage).<sup>472</sup>

The rule also expressly provides that an issuer may continue to rely upon it with respect to sales made after such issuer completes its initial public offering (IPO) and becomes a

---

<sup>468</sup> See Watson, Ess, Marshall & Enggas, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,810, at 78,159 (June 23, 1988).

<sup>469</sup> Sentinel Group, Inc., 1988 SEC No-Act. LEXIS 1484 (Nov. 14, 1988).

<sup>470</sup> 17 C.F.R. § 239.16b (1993) (General Instruction A(1)(a)) (stating "the term 'employee' also includes former employees as well as executors, administrators or beneficiaries of the estates of deceased employees, guardians or members of a committee for incompetent former employees, or similar persons duly authorized by law to administer the estate or assets of former employees").

<sup>471</sup> *Id.* § 230.701(a).

<sup>472</sup> See Jackson, Tufts, Cole & Black, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,807, at 78,150 (May 5, 1988).



public reporting company if such sales are pursuant to offers made in compliance with the rule before such time.<sup>473</sup> This extension will permit a smooth transition until the company is able to put Form S-8 registrations in place.<sup>474</sup>

*e. Conditions To Be Met*

The Rule 701 exemption is available to an eligible issuer with respect to eligible offers and sales only if both of the following conditions are met:

(1) *Delivery of A Copy of the Plan or Contract to Each Participant or Party.* The issuer, its parent or majority-owned subsidiary must provide each participant in a compensatory benefit plan and each party to a compensatory contract with a copy of the respective plan or contract. The rule requires actual delivery of the document, not just availability or provision upon request.<sup>475</sup> Since the Rule 701 exemption is not conditioned on delivery of any specified information, the purpose of the requirement would appear to be to ensure that each participant or party possesses, at a minimum, the disclosure afforded by the operative document itself in making whatever investment decision may be involved.<sup>476</sup>

---

<sup>473</sup> 17 C.F.R. § 230.701(a) (1993). The SEC has confirmed availability of the Rule 701 exemption for issuance of shares by a reporting company upon exercise of stock options originally granted under an eligible plan by a predecessor nonreporting company that the reporting company had acquired. *Devon Energy Corp.*, 1989 SEC No-Act. LEXIS 690, at \*1 (May 12, 1989). The reporting company had assumed the obligation to issue its own shares under the predecessor's options as part of the acquisition. Subsequently, the SEC found that the Rule 701 exemption would also be available for options granted after an issuer became a reporting company under § 13 or 15(d) of the Exchange Act if such options were granted in replacement of options originally issued under an eligible compensatory plan or contract while the issuer was still a nonreporting company. *I-Stat Corp.*, 1992 SEC No-Act. LEXIS 663 (May 19, 1992).

<sup>474</sup> The need for a transition was, of course, greater before the 1990 revisions to Form S-8 because: (1) a 90-day waiting period was required between effectiveness of the IPO and filing of the Form S-8 and (2) the Form S-8 did not become effective until 20 days after filing. The 1990 revisions eliminated the 90-day waiting period and made Form S-8s effective upon filing. See *supra* notes 453-56 and accompanying text.

<sup>475</sup> 17 C.F.R. § 230.701(b)(3) (1993).

<sup>476</sup> Rule 701 Adopting Release, *supra* note 449, at 89,064. The SEC has indicated that, in the case of a plan subject to the reporting and disclosure requirements of Title

The rule does not specify when the copy must be delivered. It also does not specify whether an issuer's failure to deliver a copy to one participant has the effect of making the exemption unavailable with respect to transactions with that participant alone, with respect to all transactions under such plan or with respect to all transactions by the issuer. On the first issue, the most logical interpretation would be that the plan or contract must be delivered before the investment decision is made. In *Jackson, Tufts, Cole & Black*,<sup>477</sup> the SEC indicated that the written disclosure *should* be delivered before the offer is made, but *must* be delivered before the sale is made.<sup>478</sup>

On the second issue, the answer is not clear. A basic corollary of the SEC's integration doctrine is that all offers and sales that are part of the same "offering" must meet all the conditions for availability of a transactional exemption or the exemption is unavailable for the entire offering.<sup>479</sup> Assuming this strict approach to integration applies, failure to deliver documents to even one investor would theoretically destroy the exemption with respect to all.<sup>480</sup> The SEC's integration doc-

---

I of ERISA (e.g., an ESOP or 401(k) plan) delivery to each participant of the required ERISA summary plan description and modification summaries would suffice for purposes of Rule 701 as a substitute for delivery of the plan itself (so long as the plan is available upon request). In *American Bar Association; In re Rule 701*, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,889, at 78,463 (Sept. 6, 1988).

<sup>477</sup> SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,807, at 78,150 (May 5, 1988).

<sup>478</sup> *Id.*; see also *Praxis Biologies, Inc.*, SEC No-Action Letter, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,302, at 79,114 (May 12, 1989) (stating that although written compensatory agreements were not in existence at time warrants were issued to nonemployee advisers and consultants, Rule 701 was available for issuances of shares upon exercise of warrants if written agreements memorializing contracts were executed prior to exercise of warrants).

<sup>479</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 155, 195.

<sup>480</sup> This is precisely the sort of situation that Rule 508 was meant to rectify under Regulation D. See *Financing a Small Business (Part I)*, *supra* note 416, at 223-26. If Rule 701 had an insignificant deviation rule equivalent to Rule 508, an issuer might be able to show that it had made a good faith effort to comply with all the terms and conditions of Rule 701 and that its failure to deliver a copy of the plan or contract to one employee was insignificant to the offering as a whole. This might leave the issuer exposed to a rescission action by the employee who actually did not receive the plan document or contract (since that employee was particularly disadvantaged by the

trine, however, does not apply to Rule 701 the same way it applies to other transactional exemptions. Rule 701(b)(6) provides that offers and sales exempt pursuant to Rule 701 are "deemed to be part of a single, discrete offering and are not subject to integration with any other offering or sale whether registered under the Act or otherwise exempt from registration."<sup>481</sup> This extraordinary departure from other transactional exemptions sets offers and sales made in reliance on Rule 701 apart and shields them from loss of exemption based on integration with other offers and sales.<sup>482</sup>

Non-integration means that the Rule 701 exemption will not be lost simply because a contemporaneous offer or sale with the same characteristics fails to comply with the Rule 701 prerequisites, at least if the offer or sale not covered by Rule 701 is registered or covered by another exemption. If an issuer fails to deliver a copy of a stock option plan to one plan participant, but otherwise has a valid section 4(2) exemption for the offer and sale to such participant, Rule 701(b)(6) should prevent integration and preserve the Rule 701 exemption as it applies to the other participants.<sup>483</sup> On the other hand, if the issuer could not prove the availability of any other exemption

---

deviation) and to enforcement actions by the SEC, but it would save the issuer from rescission liability to all the other employees. For analysis of a similar situation under Rule 508, see HICKS, *supra* note 381, § 7.08[3][b].

The problem is, of course, that Rule 701 does not have an insignificant deviation provision like Rule 508. Although they were proposed concurrently, Rule 701 was finalized before Rule 508, and the SEC did not go back and amend the Rule 701 exemption to include the concept it had just added to Regulation D.

<sup>481</sup> 17 C.F.R. § 230.701(b)(6) (1993).

<sup>482</sup> The shield appears to operate to protect the Rule 701 exemption only. As with the safe harbor provision in Regulation D, the protection is unidirectional. *Accord* HICKS, *supra* note 381, § 8.03[b][ii]; *see also* *Financing a Small Business (Part I)*, *supra* note 416, at 202-03 (discussing safe harbor under Regulation D). The SEC indicated this in the Rule 701 Adopting Release by noting that "as public offerings are permitted under Rule 701, a general solicitation issue may result where offering materials for a Rule 701 transaction are generally used and an issuer is relying upon some other exemption for limited offering involving the same or a similar compensation plan or arrangement." Rule 701 Adopting Release, *supra* note 449, at 89,063. *But cf.* Brill, *supra* note 452, at 3 (stating that "Rule 701 transactions will not be integrated with other exempt transactions and vice versa").

<sup>483</sup> *See* HICKS, *supra* note 381, § 8.03[5].



for an offer and sale to the participant who did not receive a copy of the plan, Rule 701(b)(6), strictly read, would not apply. The entire Rule 701 exemption could be lost.<sup>484</sup>

Careful issuers should establish a system to ensure that all participants receive a copy of relevant documents at the earliest possible point at which participation may be said to occur. Participation documents and contracts should include an acknowledgment by the participant or party that copies of all relevant documents have been received.<sup>485</sup>

(2) *Dollar and Share Limitations.* The amount of securities that may be subject to outstanding offers in reliance on Rule 701, plus the amount of securities sold in the preceding twelve months in reliance on Rule 701, may not exceed the greatest of: (a) \$500,000; or (b) an amount in aggregate offering price equal to fifteen percent of the issuer's total assets (as of the end of the last fiscal year); or (c) an amount of securities equal to fifteen percent of the outstanding securities of that class (deeming securities issuable pursuant to outstanding options, warrants, rights or convertible securities to be outstanding for such purpose unless they were issued under Rule 701) — provided that such amount may not exceed \$5,000,000 in aggregate offering price in any event.<sup>486</sup> The language in the rule makes the \$500,000 floor amount appear to be a lifetime limit. However, the SEC has made it clear that the

---

<sup>484</sup> Rule 701(b)(6) might be read more broadly to mean that strict integration rules simply do not apply to any aspect of Rule 701 and that deviations insignificant to the offering as a whole should therefore not result in loss of the entire Rule 701 exemption. This would, in effect, be reading an equivalent of Rule 508 into the exemption. See *supra* note 480.

<sup>485</sup> Issuers wishing to rely on Rule 701 for sales under plans or contracts in effect prior to May 20, 1988, should make sure that all participants and parties have received copies of relevant documents (and acknowledged receipt) before any sales occur in reliance on Rule 701. It is possible that the SEC could take the position that exercise of an option after May 20, 1988, by a participant then in possession of the plan would not be covered by Rule 701 if the participant did not possess the plan at the time, prior to May 20, 1988, the option was granted. That position seems, however, extremely unlikely given the interpretive advice in Jackson, Tufts, Cole & Black, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,807, at 78,150 (May 5, 1988). See *supra* note 472 and accompanying text.

<sup>486</sup> 17 C.F.R. § 230.701(b)(5)(1993).



\$500,000 amount is available in any rolling twelve-month period.<sup>487</sup>

Options are considered outstanding offers for purposes of such calculation. Although the rule does not so state, the SEC staff has taken the position that options which are not exercisable need not be included in the calculation.<sup>488</sup> Options which are unexercisable upon grant are not, therefore, included in the calculation of the Rule 701 dollar or share limitation. However, such options must be included at the point that they become exercisable. An issuer intending to rely on Rule 701 for an issuance of shares or for an option grant must add the number of sales during the twelve months preceding the date of the transaction to the number of options outstanding and exercisable on the date of the transaction in order to determine availability of the exemption on the date of the transaction. In order to ensure that Rule 701 continues to be available for an option after the date of grant, the issuer must also look forward and consider options which may become exercisable during the ensuing twelve months to make sure that the dollar or share limitation which fits on the date of grant will not be exceeded when outstanding options become exercisable.<sup>489</sup>

"Aggregate offering price" is defined to include all cash, property, notes, cancellation of debt or other consideration to be received by the issuer for the securities.<sup>490</sup> Non-cash consideration is to be valued in reference to bona fide sales of that

---

<sup>487</sup> See American Bar Association; *In re* Rule 701, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,889 (Sept. 6, 1988). The \$5,000,000 cap also applies on a rolling 12-month basis. For discussion of how the cap applies, see PLUMRIDGE ET AL., *supra* note 449, at 369-70.

<sup>488</sup> See American Bar Association; *In re* Rule 701, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,889, at 78,463 (Sept. 6, 1988). This does not mean, however, that an issuer may circumvent the Rule 701 dollar and share limitations as they apply to offers by simply including a provision in a stock option plan to the effect that "[r]equests by optionees to exercise options would be honored . . . only if and to the extent that such exercises, when added to all Rule 701 exercises during the preceding twelve months, would not exceed the Operative Ceiling." Bridge Information Systems, Inc., 1991 SEC No-Act. LEXIS 1302, at \*7 (Nov. 21, 1991).

<sup>489</sup> This problem of "latent" offers outstanding in the form of unexercisable options is discussed in PLUMRIDGE, ET AL., *supra* note 449, at 369-70.

<sup>490</sup> 17 C.F.R. § 230.701(b)(4)(i) (1993).

consideration made within a reasonable time or, in the absence of sales, based on fair value.<sup>491</sup> The Rule 701 Adopting Release indicated that the value of services by an employee need not be included in the calculation but that the value of services by a consultant or adviser must be included.<sup>492</sup>

Outstanding offers properly made in reliance on the calculation with respect to the issuer's total assets or outstanding securities may be consummated in reliance on Rule 701 even though the amount of assets or securities decreases in subsequent periods. However, the issuer cannot grant any new options or sell any additional securities under Rule 701 in reliance on the outdated calculation.<sup>493</sup> Nevertheless, the issuer may rely on an alternate formula if it provides a more advantageous calculation. For example, the issuer may have last granted options under Rule 701 using the fifteen percent-of-assets test, but may find that the fifteen-percent-of-outstanding-shares test provides a more advantageous calculation following a large issuance under some other exemption.

---

<sup>491</sup> *Id.*

<sup>492</sup> See Rule 701 Adopting Release, *supra* note 449, at 89,064.

<sup>493</sup> The SEC has given the following helpful illustration of these points:

[W]here Company A had assets of \$10,000,000 on December 31, 1986, and on May 1, 1987 issued options entitling holders to purchase 1,500,000 shares of its common stock at \$1 per share, even though Company A's assets declined to \$8,000,000 on December 31, 1987, the May 1st options would continue to be validly issued in reliance upon Rule 701 and the company could, in reliance upon the rule issue the 1,500,000 shares of common stock upon exercise of the options. Nonetheless, Company A could not issue any new options or sell any securities in reliance on the Rule 701 exemption, except for the shares issuable upon exercise of the outstanding options referred to above, until its assets increase to more than \$10,000,000 or (a) sufficient options expire so that the aggregate offering price of shares subject to outstanding options is less than 15 percent of the total assets as of the end of the most recent fiscal year, or (b) sufficient options are exercised, 12 months elapses from the date of the last such exercise and the aggregate offering price of the securities subject to outstanding options is less than 15 percent of the total assets as of the end of the most recent fiscal year.

Watson, Ess, Marshall & Enggas, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,810, at 78,159 (June 23, 1988); Jackson, Tufts, Cole & Black, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,807, at 78,150 (May 5, 1988); see also HICKS, *supra* note 381, § 8.03 [3][b][iv].

The calculation of dollar and share limitations is made under Rule 701 without aggregation<sup>494</sup> or, as previously noted, integration.<sup>495</sup> With respect to aggregation, Rule 701(b)(4)(ii) and (iii) provide that no reduction in the aggregate offering price available under Rule 701 is required as a result of other offerings under section 3(b) exemptions (e.g., Rule 504 or Rule 505). In addition, there is no requisite reduction in the aggregate offering price available under any other section 3(b) exemption as a result of offerings under Rule 701.<sup>496</sup> In other words, only offers and sales under Rule 701 aggregate to reduce availability of Rule 701.

The aggregation shield of Rule 701 is relevant only with respect to the dollar and share limitations. The integration shield in Rule 701(b)(6) is relevant for all purposes. As noted, Rule 701(b)(6) specifies that all offers and sales under Rule 701 constitute one big offering.<sup>497</sup> If an issuer is relying on Rule 701 for transactions under three stock option plans, an employee stock purchase plan and contracts with eight consultants, all such transactions in all aspects must be lumped together to determine compliance. On the other hand, Rule 701(b)(6) provides that offers and sales made under Rule 701 will not be integrated with offers and sales under any other exemption so as to limit or preclude use of Rule 701.<sup>498</sup> Consequently, if an issuer determines that the offers and sales under its three stock option plans, employee stock purchase plan and consulting contracts may not all be made within the Rule 701 limitations, it may rely on another exemption (such as section 4(2) or Rule 504 in Regulation D) for some of the transactions. The issuer may also conduct normal capital-raising transactions in reliance

---

<sup>494</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 155-56.

<sup>495</sup> See *supra* notes 481-84 and accompanying text.

<sup>496</sup> Unlike the Rule 701 integration shield, the aggregation shield explicitly works in both directions: Rule 701 offerings do not reduce other exemptions, and offerings under other exemptions do not reduce Rule 701. See *supra* note 482.

<sup>497</sup> 17 C.F.R. § 230.701(b)(6)(1993).

<sup>498</sup> See *supra* notes 481-84 and accompanying text.



on other exemptions without the fear that such activities will destroy the Rule 701 exemption.<sup>499</sup>

The dollar and share limitations of Rule 701 will be restrictive for many issuers, especially where assets and outstanding securities are limited and large numbers of outstanding options reduce availability of the exemption for ongoing sales over a period of years. If Rule 701 is not adequate to cover all proposed compensatory transactions, issuers will be required to carefully plan in advance, reserving Rule 701 for those eligible transactions least likely to be exempt from registration under other provisions.<sup>500</sup>

Issuers relying on Rule 701 should keep a written record of the number of offers outstanding at the time of, and the number of sales during the twelve months preceding, each offer and sale transaction sought to be covered. Documenting those calculations at the time of each purported Rule 701 transaction can be accomplished by having issuer personnel complete a standardized worksheet or checklist. Without such documentation it may be very difficult for an issuer to reconstruct the relevant numbers as of a particular date in order to provide necessary backup for any future legal opinions on Rule 701 status of shares (*e.g.*, in connection with a sale under Rule 144) or meet its burden of proving an exemption in the event problems arise in the future.<sup>501</sup>

(3) *Other Numerical Limitations; General Solicitation and Advertising.* Rule 701 has no numerical or sophistication requirements with respect to offerees or purchasers, and the exemption is not conditioned on an absence of general solicitation or advertising. Use of general solicitation or advertising in connection with a compensatory plan could prevent reliance on

---

<sup>499</sup> See HICKS, *supra* note 381, § 8.03[5].

<sup>500</sup> For example, an issuer may rely on Rule 701 to cover grants under a stock option plan to rank-and-file employees and simultaneously rely on the § 4(2) private placement exemption for grants under the same plan to the upper echelons of management. HICKS, *supra* note 381, § 8.03[5]; see also Brill, *supra* note 452, at 3.

<sup>501</sup> For an example of a Rule 701 checklist to be used by the issuer, a legal opinion on Rule 701 availability and a related opinion back-up certificate covering relevant factual considerations, see PLUMRIDGE, ET AL., *supra* note 449, at 387-95.

section 4(2), Rules 505 and 506 under Regulation D or any other exemption conditioned on absence of such factors with respect to any portion of the offers or sales pursuant to such plan.<sup>502</sup>

(4) *No Election.* Preliminary Note 3 to Rule 701 makes it clear that attempted compliance with Rule 701 does not constitute an exclusive election. The issuer may also claim the availability of any other applicable Securities Act exemption (such as the section 4(2) exemption or one or more of the Regulation D exemptions) with respect to the offers and sales in question. However, given the inherent difficulties of conforming compensatory transactions to other exemptions and the liberality of Rule 701, fall-back exemptions may be difficult to find where there has been a failed attempt to comply with Rule 701.

### 3. Disclosure

Availability of Rule 701 is not conditioned on the delivery of any specific information other than a copy of the relevant compensatory plan or contract. The preliminary notes to Rule 701, however, remind issuers that the rule constitutes an exemption from the Securities Act *registration* provisions but not from the securities *antifraud* provisions which impose an affirmative duty on an issuer not to make material misstatements or omissions in connection with a sale of its securities.<sup>503</sup> Compliance with the securities antifraud provisions and practical good sense may dictate delivery of information regarding the issuer's financial condition and any significant developments in its business as well as disclosure regarding plan operation, funding and performance, significant tax matters, the material attributes of the securities involved and restrictions on resale of such securities. The legal and practical necessity of providing such information will vary, depending upon the type of plan and the nature of the participants.<sup>504</sup>

---

<sup>502</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 204-13.

<sup>503</sup> 17 C.F.R. § 230.701 (1993) (Preliminary Note 3).

<sup>504</sup> Disclosure may also be required under other statutes, such as ERISA.

#### 4. *Limitation on Resale*

Like securities sold pursuant to section 4(2) or Rules 505 and 506 of Regulation D, securities sold pursuant to Rule 701 are "restricted securities" as defined in Rule 144 under the Securities Act.<sup>505</sup> As a practical matter, restricted securities may only be resold into a public market in compliance with the Rule 144 current public information, volume, manner of sale and notice requirements following completion of a two-year holding period. Following completion of a three-year holding period, holders other than affiliates (officers, directors or significant shareholders) of the issuer may generally resell restricted securities without compliance with any of the Rule 144 requirements.<sup>506</sup> Under certain circumstances, restricted securities may also be resold to qualified institutional buyers (QIBs) pursuant to Rule 144A under the Securities Act or in private transactions outside the confines of Rule 144 and Rule 144A.<sup>507</sup>

Rule 701(c)(3) provides that, beginning ninety days after the issuer becomes subject to the Exchange Act reporting requirements,<sup>508</sup> securities sold in Rule 701 transactions may be resold under Rule 144, by a nonaffiliate, without compliance with the current public information, holding period, volume or notice requirements and, by an affiliate, without compliance with the holding period requirement.<sup>509</sup> In essence, this means that ninety days after an issuer's initial public offering,

---

<sup>505</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 217 n.348. Securities sold under Rule 701 are "restricted securities" whether they are sold in transactions that are public or private in nature (*i.e.*, whether there is or is not general solicitation or advertising involved). Unlike Rules 505 and 506, Rule 701 poses no condition or requirement that the issuer take precautions to ensure compliance with the resale restrictions applicable to Rule 701 securities. See *Financing a Small Business (Part I)*, *supra* note 416, at 215-17. The issuer has a legal obligation to prevent an illegal redistribution, but compliance is neither a condition nor a requirement of the exemption. See HICKS, *supra* note 381, § 8.03[4].

<sup>506</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 217-19.

<sup>507</sup> See *id.* at 219-20.

<sup>508</sup> See *id.* at 155.

<sup>509</sup> 17 C.F.R. § 230.701(c)(3) (1993).



Rule 701 securities will have the same basic liquidity as nonrestricted securities issued in the registered offering.

The resale relief provision in Rule 701(c)(3) applies to "securities issued in a [Rule 701] transaction."<sup>510</sup> On its face, the resale relief provision appears to adhere to the securities even if they are transferred privately after issuance to new holders. For example, shares acquired in a Rule 701 transaction six months before the initial public offering of the issuer could be eligible for resale into the public market ninety days after effectiveness of the offering even though the original purchaser had transferred his shares to someone with absolutely no employment or other relationship with the issuer. The SEC staff has issued interpretive advice that supports this reading of Rule 701(c)(3) insofar as it applies to transferees by marital dissolution or transfers by gift.<sup>511</sup> However, in *Central Point Software, Inc.*,<sup>512</sup> the staff indicated more recently that an ordinary private resale of securities issued under Rule 701 terminates application of Rule 701(c)(3), and a transferee in such a transaction is not eligible for relief from resale restrictions.<sup>513</sup> Although the *Central Point Software* letter did not indicate whether the staff was reconsidering its position with respect to marital dissolution and gifts, one commentator has

---

<sup>510</sup> *Id.*

<sup>511</sup> See Trimble Navigation, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,702 (Jan. 29, 1991) (Rule 701(c)(3) available to ex-wife selling shares issued to husband under Rule 701 and transferred to wife in marital dissolution); Brobeck, Phleger & Harrison, 1992 SEC No-Act. LEXIS 888, at \*1 (Aug. 27, 1992) (Rule 701(c)(3) available to donee of original issuee); see also Robert A. Barron, *Control and Restricted Securities — SEC Rule 701: Does Rule 701 Status "Flow Through" to Transferees?*, 21 SEC. REG. L.J. 330, 333-35 (1993).

<sup>512</sup> 1993 SEC No-Act. LEXIS 393 (Mar. 9, 1993).

<sup>513</sup> *Central Point Software, Inc.*, 1993 SEC No-Act LEXIS at \*1. The incoming letter assumed that neither the issuee nor the transferees were affiliates of the issuer. *Id.* at \*4. The SEC's position in *Central Point Software* appears to be inconsistent with the language of the rule and previous interpretive advice. See *supra* note 479. It also seems inconsistent with the premise underlying the 1990 revisions to Rule 144, i.e., that private transfers of restricted securities between nonaffiliates should not affect the availability of Rule 144. See *Financing a Small Business (Part I)*, *supra* note 416, at 218-19; see also, Barron, *supra* note 511, at 337-38.

predicted that the SEC will confirm application of the resale relief provision to bona fide pledges.<sup>514</sup>

### 5. *Form 701*

In addition to Rule 701, the SEC also adopted Rules 702T and 703T in 1988.<sup>515</sup> Rule 702T required an issuer relying on Rule 701 to file a one-page notification on Form 701 with the SEC not later than thirty days after the first sale of securities bringing aggregate Rule 701 sales above \$100,000. Thereafter, the issuer was required to file annually within thirty days following the end of the issuer's fiscal year. Filing of Form 701 was *not* a condition to availability of the Rule 701 exemption. Under Rule 703T, however, the exemption could have become unavailable to any issuer which was the subject of a court order, judgment or decree enjoining further failure to file Form 701. The requirement was essentially identical to the Form D filing requirement as revised in 1989.<sup>516</sup>

In March 1993, the five-year term of Rules 702T and 703T expired without any action by the SEC to renew the requirement. No filings need be made for either ongoing or new Rule 701 offerings.

## C. *The Intrastate Exemption*

### 1. *General*

Section 3(a)(11) of the Securities Act exempts from registration "[a]ny security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing

---

<sup>514</sup> Barron, *supra* note 511, at 336. Barron stated that "the flow through of Rule 701 status should apply in the bona fide pledge situation. The SEC staff has traditionally treated the gift situation in a similar manner to the bona fide pledge situation for Rule 144 and Rule 144(k) purposes." *Id.*

<sup>515</sup> 17 C.F.R. § 230.702T, -.703T (these sections expired in 1993).

<sup>516</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 220-22.

business within, such State or Territory.”<sup>517</sup> Although section 3 of the Securities Act deals with exempt securities, section 3(a)(11) is really a transactional exemption since its availability depends on the particular transaction in question, not on the nature of the instrument being offered or sold.<sup>518</sup>

---

<sup>517</sup> 15 U.S.C. § 77c(a)(11) (1988). For books and articles discussing the statutory § 3(a)(11) exemption and the SEC's safe harbor Rule 147 thereunder, see HICKS, *supra* note 381, § 4.01-.09; JENNINGS ET AL., *supra* note 381, at 389-408; 3 LOSS & SELIGMAN, 1274-1307 (3d ed. 1989 & Supp. 1992); Tom A. Alberg & Martin E. Lybecker, *New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities*, 74 COLUM. L. REV. 622 (1974); Harold S. Bloomenthal, *The Federal Securities Act Intra-State Exemption — Fact or Fiction?*, 15 WYO. L.J. 121 (1961); Eric L. Cummings, *Intrastate Exemption and the Shallow Harbor of Rule 147*, 69 NW. U. L. REV. 167 (1974); Kevin C. Dicken, Comment, *Rule 147: Those Hard to Find No-Action Letters*, 17 CAP. U. L. REV. 17 (1987); J. Richard Emens & John R. Thomas, *The Intrastate Exemption of the Securities Act of 1933 in 1971*, 40 U. CIN. L. REV. 779 (1971); Donald B. Gardiner, *Intrastate Offering Exemption: Rule 147 — Progress or Stalemate?*, 35 OHIO ST. L.J. 340 (1974); J. William Hicks, *Intrastate Offerings Under Rule 147*, 72 MICH. L. REV. 463 (1974); Robert S. Kant, *SEC Rule 147 — A Further Narrowing of the Intrastate Offering Exemption*, 30 BUS. LAW. 73 (1974); Joseph C. Long, *A Lawyer's Guide to the Intrastate Exemption and Rule 147*, 24 DRAKE L. REV. 471 (1975); Daniel J. McCauley Jr., *Intrastate Securities Transactions Under the Federal Securities Act*, 107 U. PA. L. REV. 937 (1959); Daniel J. Morrissey, *Think Globally, Act Locally: It's Time to Reform the Intrastate Exemption*, 20 SEC. REG. L.J. 59 (1992); Sidney Sosin, *The Intrastate Exemption: Public Offerings and the Issue Concept*, 16 CASE W. RES. L. REV. 110 (1964); Hugh L. Sowards, *The Twilight of the Intrastate Exemption*, 25 MERCER L. REV. 437 (1974); Allen E. Throop & Chester T. Lane, *Some Problems of Exemption under the Securities Act of 1933*, 4 LAW & CONTEMP. PROBS. 89, 107-111 (1937); James A. Askew, Comment, *New Approach to the Intrastate Exemption: Rule 147 vs. Section 3(a)(11)*, 62 CAL. L. REV. 195 (1974); Lindsay E. Fischer, Comment, *Securities Regulation: Problems Involved in Understanding and Utilizing The "Intrastate" (3(a)(11)) Exemption*, 31 ROCKY MTN. L. REV. 186 (1959); David L. Hotchkiss, Comment, *SEC Rule 147 — Distilling Substance from the Spirit of the Intrastate Exemption*, 79 DICK. L. REV. 18 (1974); Wade McClure, Comment, *Securities Regulation: SEC Rule 147: Ten Years of SEC Interpretation*, 38 OKLA. L. REV. 507 (1985); Kenneth M. Royalty, Comment, *The Intrastate Exemption: Current Law, Local Practice and the Wheat Report*, 31 OHIO ST. L.J. 521 (1970).

<sup>518</sup> See Adoption of Rule 147, Securities Act Release, No. 5450, 1 Fed. Sec. L. Rep. (CCH) ¶ 2340, at 2611-2 (Jan. 7, 1974) [hereinafter Rule 147 Adopting Release]; Interpretation of 1961 Intrastate Exemption, Securities Act Release No. 4434, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 2270-77, at 2607-11 (Dec. 6, 1961) [hereinafter 1961 Intrastate Interpretive Release]; Morrissey, *supra* note 517, at 64. Placement of the intrastate exemption in § 3 rather than § 4 of the Securities Act has been described as a “legislative accident.” See LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 272-73 (2d ed. 1988).



The exemption is not premised on lack of federal jurisdiction. Instead, it is premised on the somewhat quaint notion that investors in an offering that is "local" in nature will be "protected both by their proximity to the issuer and by state regulation."<sup>519</sup> Therefore, the requirements of the exemption focus on identifying the local nature of an offering and not the limited size of the offering or the ability of investors to fend for themselves in obtaining the informational equivalent of registration. An offering in compliance with the requirements of the intrastate exemption does not cease to be exempt simply because the issuer employs the mails or other facilities of interstate commerce.<sup>520</sup>

In order for the exemption to apply, the person claiming it must prove that: (1) the issuer is a resident of the state in which the offering is to occur and, if it is a corporation, that it is incorporated in that state; (2) the issuer is doing a substantial amount of its business in that state;<sup>521</sup> (3) the proceeds of the offering are to be used within that state; (4) all offerees and purchasers are residents of that state;<sup>522</sup> (5) the securities offered have "come to rest" in the hands of the resident purchasers;<sup>523</sup> and (6) the entire "issue" of securities was of-

---

The transactional nature of the § 3(a)(11) exemption also means that persons acquiring securities issued in intrastate transactions must have another exemption available from Securities Act registration in order to reoffer and resell such securities. See Rule 147 Adopting Release, *supra*, at 2611-7.

<sup>519</sup> Rule 147 Adopting Release, *supra* note 518, at 2611-2.

<sup>520</sup> See 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2276, at 2610.

<sup>521</sup> *Chapman v. Dunn*, 414 F.2d 153, 159 (6th Cir. 1969) (*citing* SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953)); see also 17 C.F.R. § 230.147 (Preliminary Note 3) (1993).

<sup>522</sup> See 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2272, at 2608 ("A basic condition for the exemption is that the entire issue of securities be offered and sold exclusively to residents of the state in question. Consequently, an offer to a nonresident which is considered a part of the intrastate issue will render the exemption unavailable to the entire offering."); see also SEC v. Spence & Green, 612 F.2d 896, 902 (5th Cir. 1980), *cert. denied*, 1082 (1981); *Capital Funds, Inc. v. SEC*, 348 F.2d 582, 586 (8th Cir. 1965).

<sup>523</sup> 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2275, at 2610.

The SEC uses the phrase "come to rest" to describe its requirement that the securities sold under the intrastate exemption be held by the original purchasers (or by subsequent purchasers who also reside in the state) for more

ferred and sold pursuant to section 3(a)(11).<sup>524</sup> Availability of the intrastate exemption is conditioned on strict compliance with all of these requirements.<sup>525</sup> There is no insignificant deviation provision in the intrastate exemption.<sup>526</sup>

There are no quantitative or qualitative requirements (other than residency) for offerees or purchasers under the intrastate exemption. Issuers are permitted to use general solicitation or advertising to make offers within the state.<sup>527</sup> Consequently, subject to the requirement that no offers may be made to nonresidents, an exempt intrastate offering may be "public" in nature.<sup>528</sup>

There is also no requirement that any particular disclosure be delivered as a condition to availability of the exemption. Like the other exemptions discussed in this article, however,

---

than a brief period of time. Without such a requirement, the intent of section 3(a)(11) could be easily evaded by using the initial purchasers as conduits to place the securities in the hands of out-of-state residents.

HICKS, *supra* note 381, § 4.01 n.7; see also *infra* notes 589-95 and accompanying text.

<sup>524</sup> The same integration concept discussed in connection with the Regulation D exemptions applies to the intrastate exemption. See *Financing a Small Business (Part I)*, *supra* note 416, at 195-97. In fact, the SEC originally enunciated the five-factor test that it uses to identify the offers and sales making up an "offering" for purposes of the Regulation D and the § 4(2) exemptions in the context of the intrastate exemption. See 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2272, at 2608.

<sup>525</sup> For cases in which a sale to only one nonresident was held to destroy the entire exemption, see *In re Professional Investors, Inc.*, 37 S.E.C. 173, 175 (1956); *In re Edsco Mfg. Co.*, 40 S.E.C. 865, 869 (1961); *Universal Service Corp.*, 37 S.E.C. 559, 564 (1957); *Peterson Engine Co.*, 2 S.E.C. 893, 903 (1937).

<sup>526</sup> For discussion of the insignificant deviation provision in Rule 508 of Regulation D under the Securities Act, see *Financing a Small Business (Part I)*, *supra* note 416, at 222-26. One commentator has suggested that addition of such a provision to SEC Rule 147 would be a way to reinvigorate the intrastate exemption as a tool for small business financing. See Morrissey, *supra* note 517, at 86.

<sup>527</sup> For a description of the prohibition on general solicitation and advertising under the Rule 505 and 506 exemptions of Regulation D, see *Financing a Small Business (Part I)*, *supra* note 416, at 204-13.

<sup>528</sup> Subject to the "coming to rest" requirement, there are also no limitations on resale for shares sold in an intrastate offering. Such shares could, theoretically, be freely traded among residents of the relevant state. They are not "restricted securities" within the meaning of Rule 144 under the Securities Act like securities sold under Rules 505 or 506 of Regulation D, the § 4(2) private placement exemption or Rule 701 under the Securities Act. See *Financing a Small Business (Part I)*, *supra* note 416, at 217-19.

section 3(a)(11) is not an exemption from the antifraud provisions of the federal securities laws.<sup>529</sup>

The language of section 3(a)(11) is far from precise. In 1961, the SEC published a general release on section 3(a)(11) to give interpretive guidance.<sup>530</sup> SEC and court interpretations regarding the scope and terms of the exemption have been quite restrictive.<sup>531</sup> Commentators have suggested this strict approach reflects the basic distrust that the SEC and the courts have for an exemption that permits general solicitation without mandatory disclosure.<sup>532</sup>

In 1974, the SEC adopted Rule 147 as a safe harbor in order to provide objective guidelines for determining availability of the section 3(a)(11) exemption.<sup>533</sup> Consistent with its prior interpretive approach to the exemption, the SEC devised a very confining safe harbor in Rule 147, offering "certainty at the price of strictness."<sup>534</sup> Although the Rule 147 safe harbor is clearly not the exclusive means of complying with the intrastate exemption,<sup>535</sup> the SEC has indicated that it will generally not give interpretive advice regarding availability of the section 3(a)(11) exemption outside the bounds of the safe harbor.<sup>536</sup>

---

<sup>529</sup> See 17 C.F.R. § 230.147 (Preliminary Note 3) (1993) ("Rule 147 relates to transactions exempted from the registration requirements of section 5 of the Act by § 3(a)(11). Neither the rule nor section 3(a)(11) provides an exemption from the registration requirements of § 12(g) of the Securities Exchange Act of 1934, the anti-fraud provisions of the federal securities laws, the civil liability provisions of § 12(2) of the Act or other provisions of the federal securities laws.").

<sup>530</sup> 1961 Intrastate Interpretive Release, *supra* note 518.

<sup>531</sup> See HICKS, *supra* note 381, § 4.01[1]; Morrissey, *supra* note 517, at 65.

<sup>532</sup> See, Morrissey, *supra* note 517, at 65 (discussing "the SEC's latent distrust of an exemption that makes no specific provision for disclosure and contains neither an upward limit on the number of investors nor any stipulations about their qualifications"); Gardiner, *supra* note 517, at 349-53 (discussing SEC's "visceral distrust of the exemption").

<sup>533</sup> See generally Rule 147 Adopting Release, *supra* note 518.

<sup>534</sup> 3 LOSS & SELIGMAN, *supra* note 381, at 1275. Rule 147 has been called a "shallow harbor." See Cummings, *supra* note 517; Kant, *supra* note 517, at 74-76.

<sup>535</sup> 17 C.F.R. § 230.147 (Preliminary Note 1) (1993).

<sup>536</sup> See Rule 147 Adopting Release, *supra* note 518, at 2611-7 (indicating that interpretive advice outside the safe harbor will be offered "only on an infrequent basis and in the most compelling circumstances"); West Seattle Food Co-op, 1983 SEC No-Act. LEXIS 1640 (Jan. 17, 1983); Tagg's Ltd., 1984 SEC No-Act. LEXIS 1748 (Feb. 16, 1984).



Due to the strictures of the safe harbor, the narrowness of court and SEC interpretations of the statutory exemption and the increasingly interstate and international reach of even the smallest businesses, the intrastate exemption is of little practical use today.<sup>537</sup> A brief review of the scope and requirements of section 3(a)(11) and the Rule 147 safe harbor shows why experienced practitioners rarely, if ever, advise issuers to rely on it as anything more than a backstop for other available exemptions.

## 2. Availability of the Exemption

Rule 147, by its terms, is available only to issuers.<sup>538</sup> The statutory exemption, however, has been interpreted as being available to issuers as well as their controlling persons (assuming the exemption would have been available to the issuer at the time of the offers and sales by the controlling person).<sup>539</sup> Thus, the residence of the controlling person relying on the statutory exemption is deemed irrelevant.<sup>540</sup>

The intrastate exemption is available for all types of securities of all types of issuers, both public and nonpublic. The

---

<sup>537</sup> See, e.g., Edward N. Gadsby, *The Securities and Exchange Commission and the Financing of Small Businesses*, 14 BUS. LAW. 144, 148 (1964) (describing exemption "as a practical matter" to be "loaded with dynamite"); Ray Garrett, Jr., *Federal Securities Act — An Introduction to Jurisdiction*, 1961 U. ILL. L. REV. 267, 284 (1961) (describing exemption as "more an opportunity for trouble than relief"); Kant, *supra* note 517, at 74-76 (describing exemption as "extremely dangerous to rely upon . . . except under almost laboratory conditions"); Sosin, *supra* note 517, at 130 (stating that "[i]n proposed public intrastate distributions, the lawyer must necessarily sound like an oracle of doom.").

One prominent commentator has suggested that the SEC adopt a viable new exemption for local offerings based on its combined authority under § 3(a)(11) and § 3(b). Such an exemption could eliminate some of the unworkable § 3(a)(11) requirements (such as domestic incorporation of the issuer) for offerings under the \$5,000,000 § 3(b) ceiling. See generally Carl W. Schneider, *Small Business Capital Raising — The Need for Further SEC Initiatives*, INSIGHTS, Feb. 1993, at 2.

<sup>538</sup> 17 C.F.R. § 230.147 (Preliminary Note 4) (1993).

<sup>539</sup> *Id.*; see also 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2274, at 2609; SEC v. Allison, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,774, at 93,929-34 (N.D. Cal. 1982). For discussion of secondary transactions under § 3(a)(11), see HICKS, *supra* note 381, § 4.02[2].

<sup>540</sup> 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2274, at 2609.

exemption is not, however, available for any type of security issued by a registered investment company.<sup>541</sup> The SEC takes the position that the prohibition in section 24(d) of the Investment Company Act is also applicable to securities issued by a company that is required to register under the Investment Company Act, but is not so registered.<sup>542</sup>

Availability of the intrastate exemption is not limited under either section 3(a)(11) or Rule 147 by the purpose of the security issuance. The exemption may be used for financing, compensation, or any other purposes,<sup>543</sup> such as mergers and other business combination transactions that meet its conditions.<sup>544</sup>

### 3. *Residency of the Issuer*

Section 3(a)(11) requires that the issuer be a resident of the state where its offerees and purchasers reside. Corporate issuers must be incorporated in the state.<sup>545</sup> Noncorporate issuers, like limited and general partnerships, have posed problems under the statutory exemption. Should residency be determined at the entity level or the partner level? The courts

---

<sup>541</sup> 15 U.S.C. § 80a-24(d) (1988).

<sup>542</sup> *Townsend Corp. of Am.*, Investment Company Act Release No. 4045, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,120, at 82,063-87 (Sept. 2, 1964); *NJR Investments Ltd. Partnership*, SEC No-Action Letter, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,655, at 78,975 (Feb. 29, 1984); *First Commerce Trust Co.*, SEC No-Action Letter, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,390, at 78,437 (Jan. 28, 1983).

<sup>543</sup> See *HICKS*, *supra* note 381, § 4.02[1][a].

<sup>544</sup> Since all offerees must be residents of the state, even one nonresident shareholder of the corporation being acquired in a stock-for-stock merger would, however, prevent reliance on the exemption. For an example of how one issuer overcame this limitation by offering shares to residents and cashing out nonresidents, see *West Side National Bank*, SEC No-Action Letter, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,431, at 76,762-63 (June 11, 1980).

<sup>545</sup> Businesses frequently incorporate under the Delaware General Corporation Law in order to enjoy certain real or perceived corporate law advantages, even though such businesses have no other connection to the State of Delaware. One of the curiosities of the intrastate exemption is that Delaware corporations based outside of the state are foreclosed from reliance on the exemption — a result that has no logical link to investor protection whether based on a theory of issuer proximity or capacity of blue sky regulators. See *supra* note 519 and accompanying text.

and SEC have now generally taken the entity approach, looking at the state of organization and principal place of business as the state of residency for section 3(a)(11) purposes.<sup>546</sup>

Rule 147 embodies this entity approach to issuer residency. Rule 147(c)(1) provides that an issuer is a resident of the state in which (a) it is incorporated or organized, if a corporation, limited partnership, trust or other form of business organization; (b) its principal office is located, if a general partnership or other form of business organized under state law; and (c) such issuer's principal residence is located, if an individual.<sup>547</sup>

#### 4. *Doing Business Within the State*

Section 3(a)(11) requires that the issuer be "doing business within" the state. As interpreted by the SEC, this requirement "can only be satisfied by the performance of substantial operational activities" in the state.<sup>548</sup> Moreover, the SEC took the position that the requirement dictates that the proceeds of the offering be used primarily for in-state purposes.<sup>549</sup> Pre-Rule 147 court cases reaffirmed that the "predominant" business of the issuer and use of proceeds must

---

<sup>546</sup> See, e.g., *Grenader v. Spitz*, 390 F. Supp. 1112 (S.D.N.Y. 1975) (holding that residence of general partnership is that of its principal place of business even where partners reside in other states); *Louisiana Motor Inns*, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,902, at 81,946-47 (May 23, 1972) (confirming availability of § 3(a)(11) to limited partnership for offering in state of organization and principal place of business even though one of corporate general partners was incorporated and had its principal place of business in neighboring state); see also Long, *supra* note 517, at 477; Morrissey, *supra* note 517, at 68-69; cf. HICKS, *supra* note 381, § 4.04[1][b] (pointing out that it is impossible to know whether SEC has completely dropped its old view that partnerships with out-of-state partners were foreclosed from reliance on statutory exemption because SEC no longer gives interpretive advice outside bounds of Rule 147).

<sup>547</sup> 17 C.F.R. § 230.147(c)(1) (1993). In one opinion letter, the SEC staff stated that, for purposes of the intrastate exemption, a limited partnership was a resident of the state in which it was legally organized and in which its principal office was located even though the corporate general partner was a wholly-owned subsidiary of an out-of-state corporation and the individual general partner was an out-of-state resident. *GHM/Massachusetts Health Care Partners-I Ltd. Partnership*, SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,808 at 78,156 (May 31, 1988).

<sup>548</sup> 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2273, at 2609.

<sup>549</sup> *Id.*



be in-state.<sup>550</sup> Also, the issuer must comply with the "doing business within" requirement throughout the entire time of the transaction and throughout the use of proceeds.<sup>551</sup>

Rule 147(c)(2) provides specificity to the "doing business" requirement by setting out four conditions, all of which must be met in order for the issuer to be within the safe harbor.

(1) *Gross Revenues*. The issuer must derive eighty percent of its consolidated gross revenues from the "operation of a business or of real property located in or from the rendering of services within" the state. The gross revenues test applies to the most recently completed fiscal year of the issuer, or, if the offering commences in the latter six months of its current year, to the first six months of the current year (or the twelve-month period then ending). The gross revenues test does not apply at all if the issuer has not had gross revenues in excess of \$5,000 from the sale of products or services or other conduct of its business for its most recent twelve-month fiscal period.<sup>552</sup>

Generally, an issuer operating a business within the state will be deemed to be generating in-state revenues from that business even if the business consists primarily of sales to out-of-state buyers or subscribers.<sup>553</sup> Where the issuer has substantial out-of-state operations, however, it may be very difficult to determine, absent SEC interpretive advice, which revenues count as in-state and which do not. For example, in *Interstate Securities Corp.*, the SEC advised a broker-dealer that it would not meet the "doing business within" requirements of Rule 147(c)(2) since its out-of-state branch offices generated approxi-

---

<sup>550</sup> See, e.g., *SEC v. Truckee Showboat, Inc.*, 157 F. Supp. 824 (S.D. Cal. 1957) (stating that intrastate exemption not available for offering to California residents where proceeds used to acquire Nevada hotel); *Chapman v. Dunn*, 414 F.2d 153, 159 (6th Cir. 1969) (holding that "predominant amount . . . of business" must be done in state); *SEC v. McDonald Invest. Co.*, 343 F. Supp. 343 (D. Minn. 1972) (same).

<sup>551</sup> For discussion of this aspect of the statutory requirement, see HICKS, *supra* note 381, § 4.04[3][c].

<sup>552</sup> 17 C.F.R. § 230.147(c)(2)(i) (1993).

<sup>553</sup> See *American Computer Communications Co.*, SEC No-Action Letter, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,686, at 86,771 (June 15, 1976); *Botto & Associates*, SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,996, at 78,912-16 (Jan. 25, 1989).

mately sixteen percent of consolidated gross revenues and its investment transactions, which were originated by traders working out-of-state, generated approximately nine percent of consolidated gross revenues.<sup>554</sup> In analyzing the out-of-state nature of the revenues, the SEC focused on whether the revenues were derived from activities which were directed by decision-making authority exercised out-of-state.

(2) *Assets*. At least eighty percent of the issuer's consolidated assets, as of the end of its most recent semiannual fiscal period prior to commencement of the offering, must be located within the state.<sup>555</sup> The SEC has indicated that assets must be computed on the basis of generally accepted accounting principles, and thus may not be based on the fair market value of assets.<sup>556</sup>

In *Leastec Corp.*, the SEC took the position that, for purposes of Rule 147, a California equipment leasing limited partnership could rely on the characterization of lease transactions under FASB Statement 13 in determining the location of partnership assets.<sup>557</sup> Under FASB Statement 13, "operating leases" are reported as if the lessor is the owner of the equipment and "sales-type leases" and "direct financing leases" are reported as if the lessor sold or financed the equipment. Consequently, under the analysis endorsed by the SEC in *Leastec Corp.*, equipment located outside the state which is leased under an "operating lease" would not qualify under the Rule 147 asset requirement, whereas the partnership asset associated with a "sales-type lease" or a "direct financing lease" would be a lease receivable which would be located in the lessor's state of residence regardless of the location of the equipment.

---

<sup>554</sup> Interstate Sec. Corp., 1982 SEC No-Act. LEXIS 3010 (Oct. 15, 1982).

<sup>555</sup> 17 C.F.R. § 230.147(c)(2)(ii) (1993).

<sup>556</sup> See Northwest Med. Resources, Inc., 1976 SEC No-Act. LEXIS 401 (Feb. 23, 1976); Berkley & Co., SEC No-Action Letter, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,356, at 85,9948-49 (Sept. 16, 1975); cf Eastern Leasing Corp., 1979 SEC No-Act. LEXIS 2819 (May 21, 1979) (not applying strict balance sheet approach to issuer in lease financing business).

<sup>557</sup> Leastec Corp., 1984 SEC No-Act. LEXIS 1546 (Jan. 9, 1984).

(3) *Net Proceeds*. The issuer must intend to use, and must use, eighty percent of the net proceeds from sales in reliance upon Rule 147 in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services, within the state.<sup>558</sup> The net proceeds test does not require that proceeds be spent only on purchases from suppliers or vendors in the state. The proceeds may be directed to any suppliers or vendors as long as the required percentage is spent "in connection with" the in-state operation, purchase or rendering of services.<sup>559</sup> Consequently, using the majority of the proceeds from an intrastate offering to retire indebtedness to an out-of-state bank incurred to finance in-state operations would not prevent reliance on Rule 147.<sup>560</sup>

From a practitioner's standpoint, the net proceeds test is one of the aspects of the intrastate exemption which makes it most unattractive. While the other tests, at least as embodied in Rule 147, may be assessed and verified before the offering commences, the net proceeds test may undo the exemption long after the offering is over.<sup>561</sup>

(4) *Principal Office*. The principal office of the issuer must be in the state.<sup>562</sup> In *Alaska Commercial Co.*, the SEC advised that the location of the principal office is the state where an entity maintains its banking, buying, legal, accounting and logistical offices, even if the majority of employees and essentially all operating assets are located in another state.<sup>563</sup>

### 5. *Residency of Offerees and Purchasers*

Section 3(a)(11) requires that all offerees and purchasers be residents of the state in which the issuer is a resident. Merely

---

<sup>558</sup> 17 C.F.R. § 230.147(c)(2)(iii) (1993).

<sup>559</sup> See HICKS, *supra* note 381, § 4.04[5][b][iii].

<sup>560</sup> Fina Bancorp, Inc., 1987 SEC No-Act. LEXIS 2141 (June 15, 1987). For additional interpretive advice on the Rule 147 net proceeds requirement, see HICKS, *supra* note 381, § 4.04[5][b][iii] n.33.

<sup>561</sup> See, e.g., *Busch v. Carpenter*, 827 F.2d 653 (10th Cir. 1987) (transferring of assets of issuer to out-of-state buyer seven months after offering indicated lack of requisite intent to use proceeds in-state at time of offering).

<sup>562</sup> 17 C.F.R. § 230.147(c)(2)(iv) (1993).

<sup>563</sup> *Alaska Commercial Co.*, 1981 SEC No-Act. LEXIS 3018 (Feb. 10, 1981).



being present in the state is insufficient. What constitutes residency for purposes of section 3(a)(11), however, depends on whether the offerees or purchasers are individuals, corporations or other business entities.<sup>564</sup> In the case of individuals, the SEC originally equated residency under section 3(a)(11) with the legal concept of "domicile" which comprises residence at a particular place as well as proof of an intention to remain there for an unlimited time.<sup>565</sup> For corporate offerees and purchasers, the SEC originally took the position that residency was in the state of incorporation and that location of principal place of business was not sufficient.<sup>566</sup> For other business entities, the SEC originally refused to look to the residency of the entity and instead required that all partners or other participants meet the residency requirement.<sup>567</sup>

Rule 147(d) constituted a significant departure from these previous positions. Rule 147(d)(2) provides that an "individual shall be deemed to be a resident of a state or territory if such individual has, at the time of the offer and sale to him, his principal residence in the state or territory."<sup>568</sup> The adoption of this "principal residence" test was meant to eliminate the inquiry into subjective intent involved with the domiciliary approach and replace it with more objective standards.<sup>569</sup> An individual may have several residences, but only one *principal* residence. An individual's principal place of residence is where the individual makes his or her home at the time of the

---

<sup>564</sup> For discussion of residency requirements under the statutory exemption, see HICKS, *supra* note 381, § 4.05[1].

<sup>565</sup> Mitchell v. United States, 88 U.S.(21 Wall.) 350, 352 (1874); see Securities Act Release No. 5349, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,168, 82,545-50 (Jan. 8, 1973); Securities Act Release No. 4386, [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,774, at 80,905-06 (July 12, 1961); HICKS, *supra* note 381, § 4.05[1][b][i]; Morrissey, *supra* note 517, at 71-72.

<sup>566</sup> See, e.g., Eau Claire Hotel, Inc., 1973 SEC No-Act. LEXIS 3361 (July 20, 1973); see also HICKS, *supra* note 381, § 4.05[1][c].

<sup>567</sup> See HICKS, *supra* note 381, § 4.05[1][d].

<sup>568</sup> 17 C.F.R. § 230.147(d)(2) (1993).

<sup>569</sup> See Securities Act Release No. 5349, *supra* note 565, at 82,546; see also HICKS, *supra* note 381, § 4.05[2][b].

transactions with the issuer, despite intentions to move from there in the future.<sup>570</sup>

In *Minnesota Cablesystems—Southwest*, the SEC considered the principal residency of a Minneapolis man who had taken a new job in Chicago. The man had listed his house in the suburbs of Minneapolis for sale with a real estate agent, but did not expect any sale to occur for thirty to ninety days. In the meantime, he spent the work week in Chicago, living in a hotel, and returned to Minneapolis to spend weekends with his family members who continued to live in the house. Although the man had a clear intention to move to Illinois, the SEC confirmed that the determination of principal residence did not turn on this. Instead, the SEC found that Minnesota remained his principal residence at the time of the transaction.<sup>571</sup>

Rule 147(d)(1) provides that a "corporation, partnership, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of the offer and sale to it, it has its principal office within such state or territory."<sup>572</sup> This change from previous interpretations under the statutory exemption reflects the SEC's evolving belief that "the location of a company's principal office is more of an indication of its local character for purposes of the offeree residence provision of the rule than is its state of incorporation."<sup>573</sup> It also reflects the view that all business entities, including partnerships, should be treated in the same manner. Rule 147(d)(3) prevents the entity approach to residency from being used to circumvent the purposes of the exemption, by providing that any business organization formed for the specific purpose of acquiring securities in the offering "shall be deemed not to be a resident of a state or territory unless all of the

---

<sup>570</sup> See HICKS, *supra* note 381, § 4.05[2][b] ("For one who resides in more than one state — for example, an individual who owns a winter home in Florida and a summer home in New England — the inquiry becomes: Where does he spend most of his time? Residency becomes a factual determination measured by time spent in one place.").

<sup>571</sup> *Minnesota Cablesystems-Southwest*, SEC No-action Letter, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,845, at 77,364-65 (Mar. 20, 1981).

<sup>572</sup> 17 C.F.R. § 230.147(d)(1) (1993).

<sup>573</sup> Rule 147 Adopting Release, *supra* note 518, at 2611-6.

beneficial owners of such organization are residents of such state or territory."<sup>574</sup>

Where persons purchase on behalf of another person or persons, the residence of such beneficial owner or owners must satisfy the requirements of the rule.<sup>575</sup> For example, a non-resident trustee of an Individual Retirement Account established for a resident beneficiary may acquire securities in an intrastate offering.<sup>576</sup> Purchase of securities by residents through out-of-state brokers will also not defeat the availability of Rule 147.<sup>577</sup>

Until 1983, the SEC took the position that offers or sales to foreign investors would destroy the intrastate exemption even though all domestic offers and sales were properly made to residents of a single state. However, in *Scientific Manufacturing, Inc.*, the SEC found that concurrent sales to foreign investors abroad would not preclude availability of the exemption if residency requirements were met with respect to all United States investors.<sup>578</sup> Subsequently, the SEC has reaffirmed this position.<sup>579</sup>

The residency requirement must be met at the time of the offer and the sale sought to be brought within the exemption. Installment payment arrangements have been a recurring source of problems in this regard. In *Opportunities Investment Associates of New London, Connecticut*, the SEC refused to confirm availability of the exemption in an offering involving

---

<sup>574</sup> 17 C.F.R. § 230.147(d)(3) (1993); see *Pittsburgh Bancshares, Inc.*, 1990 SEC No-Act. LEXIS 848 (May 30, 1990); *North Am. Invest.*, 1980 SEC No-Act. LEXIS 3022 (Mar. 17, 1980). For discussion of how entities formed for the specific purpose of investment are treated under the Regulation D exemptions, see *Financing a Small Business (Part I)*, *supra* note 416, at 168, 174-75.

<sup>575</sup> See Rule 147 Adopting Release, *supra* note 518, at 2611-6.

<sup>576</sup> See, e.g., *Fair Valley Properties No. 2*, SEC No-Action Letter, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,003, at 77,514 (Apr. 2, 1981); *Gold Coast Bancshares*, SEC No-Action Letter, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,347, at 78,302 (Sept. 21, 1982).

<sup>577</sup> See *Genesee Merchants Bank & Trust Co.*, 1982 SEC No-Act. LEXIS 1751 (Feb. 1, 1982).

<sup>578</sup> *Scientific Mfg., Inc.*, 1983 SEC No-Act. LEXIS 2447 (June 13, 1983).

<sup>579</sup> See, e.g., *Commonwealth Equity Trust*, SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,412 at 77,333 (Jan. 20, 1987).



installment payments because a resident purchaser could move to another state before paying the final installment.<sup>580</sup> However, in *Diplomat, Ltd.*, the SEC indicated that where installments were paid under a note delivered by the investor at closing and where nonpayment of an installment subjected the investor to substantial penalties, the investor could be deemed to have completed the purchase, for purposes of the Rule 147 residency requirement, at the time of closing.<sup>581</sup>

As previously noted, Rule 147 makes no allowance for insignificant deviations. Even one offer or sale to a nonresident destroys the exemption for the entire offering. Rule 147 also imposes a standard of absolute accuracy when it comes to the residency requirement. It does not matter whether the issuer has a reasonable belief that the offerees and purchasers are all residents. They must *actually* be residents.<sup>582</sup>

#### 6. *Part of an Issue*

As previously discussed, all offers to sell, offers for sale and sales which are part of the same "issue" must meet all the conditions of section 3(a)(11) and Rule 147.<sup>583</sup> The integration concept, including the SEC's five-factor test, as applied to the intrastate exemption is identical to that applied under Regulation D and the section 4(2) private placement exemption.<sup>584</sup> Rule 147(b)(2) provides a six-month safe harbor for determining whether offers and sales are part of the same issue, similar to Rule 502(a) under Regulation D.<sup>585</sup>

As in the case of the Regulation D safe harbor, the Rule 147 safe harbor protects only the Rule 147 transaction, it does

---

<sup>580</sup> Opportunities Inv. Assocs. of New London, Conn., SEC No-Action Letter, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,738, at 80,948 (June 14, 1978).

<sup>581</sup> *Diplomat, Ltd.*, 1984 SEC No-Act. LEXIS 1702, at \*1 (Feb. 13, 1984).

<sup>582</sup> Contrast this absolute standard with the liberal approach taken in Regulation D to "accredited investor" status. See *Financing a Small Business (Part I)*, *supra* note 416, at 161-63.

<sup>583</sup> See *supra* notes 524, 525.

<sup>584</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 195-97; 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2272, at 2608.

<sup>585</sup> See *id.* at 202-04.

not shield any other exemption.<sup>586</sup> One notable difference between the Rule 147 and the Regulation D safe harbors is that the Rule 147(b)(2) provision does not contain an exception for offers and sales occurring during the six-month period pursuant to an employee benefit plan. Outstanding employee options, for example, would prevent operation of the safe harbor with respect to two offerings otherwise separated by more than six months and would require application of the five-factor test.<sup>587</sup>

### 7. Limitation on Resale

In order to be exempt under section 3(a)(11), securities sold must "come to rest" in the hands of residents prior to any re-offer or resale to nonresidents and, accordingly, must be purchased without a view to distribution to nonresidents.<sup>588</sup> The SEC has suggested that this "coming to rest" process could take a full year.<sup>589</sup> Section 3(a)(11) does not impose an investment intent requirement on securities sold, only an intent not to re-offer or resell to nonresidents.<sup>590</sup> Theoretically, shares sold in an intrastate offering could be freely traded immediately if trading were limited exclusively to in-state residents.

---

<sup>586</sup> See *id.* at 202.

<sup>587</sup> For further demonstration of the limited value of the Rule 147(b)(2) safe harbor, see HICKS, *supra* note 381, § 4.03[3].

<sup>588</sup> See Securities Act Release No. 1459, 1 Fed. Sec. L. Rep. (CCH) ¶ 2262, at 2606 (May 29, 1937); 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2275, at 2610; see also *Capital Funds, Inc. v. SEC*, 348 F.2d 582, 586 (8th Cir. 1965); *SEC v. Hillsborough Investment Corp.*, 173 F. Supp. 86, 89 (D. N.H. 1959), *aff'd*, 276 F.2d 665 (1st Cir. 1960); *Stadia Oil & Uranium Co. v. Wheelis*, 251 F.2d 269, 275 (10th Cir. 1957).

<sup>589</sup> See *Brooklyn Manhattan Transit Corp.*, 1 S.E.C. 147, 153 (1935).

<sup>590</sup> See 1961 Intrastate Interpretive Release, *supra* note 518, ¶ 2275, at 2610 (indicating that securities must come to rest in hands of "persons purchasing without a view to further distribution or resale to nonresidents"); HICKS, *supra* note 381, § 4.06[1][a] (stating that "[a]lthough avid intrastate trading among residents is permitted, as a practical matter, an issuer might wish to curtail or at least severely limit any trading for a period of one year in order to guarantee that the securities have come to rest"); see also 17 C.F.R. § 230.147(e) (Note 2) (1993) (reminding dealers of their obligation under Exchange Act Rule 15c2-11 to comply with certain information requirements prior to publishing any quotation for security issued in intrastate exemption).

Rule 147(e) clarifies when an issue has come to rest by requiring that during the offering period, and for a period of nine months from the date of the last sale by the issuer, all resales of the securities purchased shall be made only to persons resident in the state. Rule 147(f) sets forth certain precautions which an issuer must take to prevent premature intrastate offers and sales of the securities acquired in a Rule 147 offering.<sup>591</sup> These precautions include providing written disclosure to the purchaser of the restrictions on resale, legending stock certificates, issuing stop transfer instructions and obtaining written representations regarding residence from all purchasers.<sup>592</sup> Compliance with such precautions is an absolute condition to availability of the Rule 147 safe harbor.<sup>593</sup> However, the Tenth Circuit Court of Appeals concluded that failure to comply with the Rule 147(e) nine-month period did not preclude reliance on the statutory exemption, and a seven-month period was held sufficient to demonstrate "coming to rest" under the statutory exemption.<sup>594</sup> In addition, the court indicated that once the issuer proved that it had offered and sold the securities exclusively to state residents, the burden of proof shifted to the plaintiff to demonstrate that the securities "had not come to rest but had been sold to people who intended to resell [them] out of state."<sup>595</sup>

---

<sup>591</sup> 17 C.F.R. § 230.147(f) (1993). For discussion of comparable precautionary steps intended to ensure compliance with the resale restrictions applicable to securities sold in reliance on Rule 505 or Rule 506 under Regulation D, see *Financing a Small Business (Part I)*, *supra* note 416, at 215-17.

<sup>592</sup> Rule 147(f)(2) also requires issuers to comply with the same precautions (except the written representation of residence requirement) when issuing a new stock certificate pursuant to a transfer made during the nine-month period following the sale. 17 C.F.R. § 230.147(f)(2) (1993).

<sup>593</sup> The SEC amended the resale limitation requirements in Rule 502(d) of Regulation D in 1989 to make comparable precautions nonmandatory. An issuer may comply with revised Rule 502(d) by taking the listed steps or by other actions. See *Financing a Small Business (Part I)*, *supra* note 416, at 215-17. The precautions of Rule 147(f), however, remain the sole means of ensuring availability of the safe harbor and create a technical trap for the unwary issuer.

<sup>594</sup> *Busch v. Carpenter*, 827 F.2d 653, 656-57 (10th Cir. 1987).

<sup>595</sup> *Busch*, 827 F.2d at 657. For an excoriating critique of the *Busch* decision, see HICKS, *supra* note 381, § 4.06[1][c].



#### IV. MISSISSIPPI BLUE SKY EXEMPTIONS FOR SMALL BUSINESS FINANCING

##### A. Background

In 1981, the Mississippi Legislature adopted the Mississippi Securities Act,<sup>596</sup> replacing the former state securities statute in its entirety.<sup>597</sup> The Mississippi Securities Act is based on the Uniform Securities Act of 1956 (the Uniform Act) developed by the National Conference of Commissioners on Uniform State Laws.<sup>598</sup>

The exemptions from registration under the Mississippi Securities Act are contained in sections 75-71-201 and 75-71-203 of the Mississippi Code.<sup>599</sup> Section 75-71-201 contains thirteen categories of exempt securities, eleven of which track the categories in section 402(a) of the Uniform Act.<sup>600</sup> The

---

<sup>596</sup> MISS. CODE ANN. §§ 75-71-101 to -735 (1991). The Mississippi Securities Act is administered by the Mississippi Secretary of State. *Id.* § 75-71-107(a). The Secretary of State has extensive rule-making authority under the Act. *See, e.g., id.* §§ 75-71-109 & 75-71-203 (13). The rules and regulations of the Mississippi Secretary of State (Mississippi Blue Sky Rules) under the Mississippi Securities Act are published by, and available upon request from, the Secretary of State's Office.

Commerce Clearing House, Inc. publishes the state securities statutes and related rules and regulations from all U.S. jurisdictions in its multi-volume *Blue Sky Reporter* looseleaf service. Securities law practitioners rely, for all intents and purposes, exclusively on the CCH *Blue Sky Law Reporter* as the standard compilation of state securities laws. The Mississippi Securities Act and Mississippi Blue Sky Rules are compiled at 2 Blue Sky L. Rep. (CCH) ¶¶ 34,133-34, 904, at 29,151-903.

<sup>597</sup> *See* 1981 Miss. Laws, ch. 521.

<sup>598</sup> 1 Blue Sky L. Rep. (CCH) ¶¶ 5500A-5707, at 1501-1754. For a description of state securities or "blue sky laws" generally, see *Financing a Small Business (Part I)*, *supra* note 416, at 131 n.1. For a general description of Mississippi's pre-1981 securities law, see Richard Baxter Wilson, Jr., Comment, *Selling the Blue Sky in Mississippi — A Comparison of the Mississippi Securities Act with the Uniform Securities Act*, 35 MISS. L.J. 421 (1964). For discussion of the exemptions from registration contained in the pre-1981 securities law, see Thomas A. Cook & Douglas Johnston Smith, Jr., Comment, *Exemptions from Registration Under the Securities Act of 1933 and Registration of Securities Under the Mississippi Securities Law*, 46 MISS. L.J. 975 (1975).

<sup>599</sup> MISS. CODE ANN. §§ 75-71-201 and -203 (1991).

<sup>600</sup> These 11 categories cover: U.S. government securities; foreign government securities; bank, savings institution or credit union securities; securities issued by railroads and other common carriers, public utilities and holding companies; exchange-

two additional categories in the Mississippi Securities Act exempt the securities of Mississippi cooperatives<sup>601</sup> and certain oil and gas securities.<sup>602</sup> Section 75-71-203 contains twelve transactional exemptions which basically follow section 402(b) of the Uniform Act.<sup>603</sup> Section 75-71-203 also contains an empowering provision, adopted in 1987, to give the Mississippi Secretary of State explicit authority to create further transactional exemptions from registration by rule based upon a finding that "(A) such registration is neither necessary in the public interest nor for the protection of investors; or (B) such exemption shall further the objectives of compatibility with federal exemptions and uniformity among the states."<sup>604</sup>

Like the exemptions under the Securities Act discussed in the preceding sections of this article, the provisions of the Mississippi Securities Act sections 75-71-201 and 75-71-203 and the related Mississippi Blue Sky Rules are only exemptions from the registration requirement of the Mississippi Securities Act.<sup>605</sup> They do not exempt any securities or transactions from the antifraud provisions of the Act.<sup>606</sup>

---

listed securities; securities of nonprofit issuers; commercial paper; and investment contracts issued under employee benefit plans. Compare MISS. CODE ANN. § 75-71-201(1)-(11) (1991) with 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1557 to 57-3.

<sup>601</sup> MISS. CODE ANN. § 75-71-201(12)(1991). Among other restrictions, this exemption is limited to cooperatives organized under Mississippi law, doing business exclusively in the state and having stockholders who are all Mississippi residents. *Id.*

<sup>602</sup> *Id.* § 75-71-201(13).

<sup>603</sup> Compare *id.* § 75-71-203(1)-(12) with 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1557-3 to 59.

<sup>604</sup> MISS. CODE ANN. § 75-71-203(13) (1991); see 1987 Miss. Laws, ch. 477, § 4; see also *Financing a Small Business (Part I)*, *supra* note 416, at 140 n.21.

<sup>605</sup> See MISS. CODE ANN. §§ 75-71-201 to -203 (1991) (introductory language).

<sup>606</sup> The principal antifraud provision under the Securities Act provides that:

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly,

(1) To employ any device, scheme or artifice to defraud;

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or

(3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

MISS. CODE ANN. § 75-71-501 (1991); see also *Financing a Small Business (Part I)*, *supra* note 416, at 147 n.52.

Judicial interpretation of the Mississippi Securities Act and the Mississippi Blue Sky Rules has been extremely sparse.<sup>607</sup> Case law from other jurisdictions which have adopted the Uniform Act and the Official Comments on the Uniform Act provide guidance, but are not controlling.<sup>608</sup> Section 75-71-111(e) of the Mississippi Securities Act authorizes the Secretary of State to respond to requests for interpretive opinions or to issue determinations not to institute enforcement proceedings against specific persons for specific activities.<sup>609</sup> To date, these opinions and no-action letters pursuant to section 75-71-111(e) have been the most significant source of interpretation regarding the exemptions from registration.<sup>610</sup> This interpre-

---

<sup>607</sup> The same was true under the pre-1981 predecessor of the Mississippi Securities Act. See Wilson, *supra* note 598, at 421 (stating "[a]s of [1964], no case has yet reached the Mississippi Supreme Court on this new blue sky law, but this is not at all surprising since the field of security regulation does not lend itself to judicial review").

<sup>608</sup> Although case law interpretation from other states and the Official Comments are not controlling, the Mississippi Legislature has indicated that they should be given deference in interpreting the Mississippi version of the Uniform Act. Section 75-71-103 of the Mississippi Code provides that "[t]his chapter shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation." MISS. CODE ANN. § 75-71-103 (1991). For a reproduction of the Official Comments on the Uniform Securities Act itself, see 1 Blue Sky L. Rep. (CCH) ¶ 5500 *et seq.* For additional commentary by Professor Louis Loss who drafted the Uniform Act, see LOUIS LOSS, COMMENTARY ON THE UNIFORM SECURITIES ACT (1976) (containing official commentary to the Uniform Act along with lengthier draftsmen's commentary). See also *Financing a Small Business (Part I)*, *supra* note 416, at 131 n.1.

<sup>609</sup> Section 75-71-111(e) of the Mississippi Code provides as follows:

The Secretary of State in his discretion may honor requests from interested persons for interpretive opinions, or may issue determinations that the Secretary of State will not institute enforcement proceedings against certain specified persons for engaging in certain specified activities when the determination is consistent with the purposes fairly intended by the policy and provisions of this chapter. The Secretary of State may charge a fee for interpretive opinions and no-action determinations.

MISS. CODE ANN. § 75-71-111(e)(1991). For a description of interpretive and no-action letters issued by the SEC under the federal securities laws, see *Financing a Small Business (Part I)*, *supra* note 416, at 144 n.37.

<sup>610</sup> Rule 125 of the Mississippi Blue Sky Rules provides that interpretations and no-action responses may only be given if sufficient facts are contained in the request and the request is not hypothetical in nature. A nonrefundable fee of \$100 must accompany each request. 2 Blue Sky L. Rep. (CCH) ¶ 34,416, 29,404-05. Interpretive opinions and no-action letters pursuant to § 75-71-111(e) of the Mississippi Code are publicly



tive/no action authority also effectively gives the Office of the Secretary of State an important "floating exemption" that may be applied at its discretion on a case-by-case basis to transactions which pose limited risk to investors, but which do not fit clearly within a particular statutory or regulatory exemption.<sup>611</sup>

*B. Principal Mississippi Blue Sky Exemptions for Small Business Financing*

The principal exemptions available for small business financing under the Mississippi Securities Act and the Missis-

---

available. Copies may be obtained from the Secretary of State upon payment of copying charges. The opinions and letters are indexed by reference to the provisions of law involved. Telephone Interview with Tammy Harthcock, Securities Division, Mississippi Secretary of State (May 15, 1993).

In 1991, Jackson lawyer L. Keith Parsons compiled, reviewed and discussed existing opinions and responses under the Mississippi Securities Act. Parsons notes that:

Generally, interpretive opinions are limited to the particular facts and circumstances set forth in the request for the interpretive opinion, and may only be relied upon by the person for whom the opinion is requested. The extent to which an interpretive opinion may be relied on as a precedent by other varies. If the opinion is defining a term or explaining generally the meaning of a particular statutory provision, the opinion should be of general application. On the other hand, where an opinion merely states the applicability of a particular provision to certain facts, the opinion would be useful to the interpreter only where the material facts at issue are identical to the material facts in the opinion. Where the material facts at issue are not identical to those contained in a prior opinion, and the application of a particular statute or regulation is unclear, it will usually still be prudent to seek an interpretive opinion.

L. Keith Parson, *A Review of Interpretive Opinions and Enforcement Proceedings Under the Mississippi Securities Act*, 12 MISS. C.L. REV. 179, 180 (1991). This article references opinions and responses discussed in the Parsons article and notes relevant opinions and responses issued since 1991.

For discussion of precedential effect of SEC no-action letters, see Richard H. Rowe, *A SEC Staff "No-Action" Position: An Impervious Shield Against Liability or a Paper Tiger?*, INSIGHTS, July 1992, at 21.

<sup>611</sup> See Letter from Michael Henry, Senior Attorney, Securities Division, Mississippi Secretary of State, to Bryn Vaaler, Professor of Law, University of Mississippi School of Law (Oct. 6, 1993) (on file with the author) (describing use of § 75-71-111(e) as a "floating exemption" in appropriate cases). For examples of using § 75-71-111 (e) as a "floating exemption," see *infra* note 626.

issippi Blue Sky Rules include: (1) the institutional exemption in section 75-71-203(8); (2) the limited offering exemption in section 75-71-203(9); (3) the Mississippi Uniform Limited Offering Exemption in Rule 703 of the Blue Sky Rules; and (4) the Mississippi domestic issuer limited offering exemption in Rule 705 of the Blue Sky Rules. These four provisions along with a number of other potentially important exemptions are discussed below.

*1. Institutional Exemption: Section 75-71-203(8)  
and Rule 103(G)*

Section 75-71-203(8) of the Mississippi Code follows the Uniform Act institutional exemption, permitting registered offers and sales by an issuer or a non-issuer to a:

[B]ank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.<sup>612</sup>

Like section 402(b)(8) of the Uniform Act, the Mississippi institutional exemption is self-effectuating (*i.e.*, there are no approval, permit or notice filing requirements). There are also no requirements or conditions relating to delivery of information, limitations on resale or investment intent or absence of general solicitation or advertising.

*a. Background*

Nearly all states exempt offers and sales to defined categories of institutional investors. The rationale for the exemption is obviously that such investors do not need the protection of registration since they have the economic bargaining power and sophistication to fend for themselves in obtaining equivalent information.<sup>613</sup> Neither the Mississippi Securities Act nor the Uniform Act contains the equivalent of the federal

---

<sup>612</sup> MISS. CODE ANN. § 75-71-203(8) (1991).

<sup>613</sup> See LOSS, *supra* note 608, at 123.

private placement exemption in section 4(2) of the Securities Act for transactions "not involving any public offering." Institutional exemptions provide the functional equivalent on the state level for an important portion of the coverage of the private placement exemption on the federal level.<sup>614</sup> The problem with the institutional exemption is that the specific categories of investor listed are so limited and the residual content of "or other financial institution or institutional buyer" is unclear. Investors who can clearly "fend for themselves" for purposes of the federal private placement exemption, such as wealthy and sophisticated individuals and families, do not appear to be contemplated by the state exemption. Other categories of professional investors who have no need for the protections afforded by blue sky registration, such as venture capital partnerships or SBICs, are only covered to the extent that they fall within the residual scope of "or other financial institution or institutional buyer." Absent clear interpretive authority on the point, issuers and their counsel may be unwilling to rely on the residual language.

*b. Qualified Institutional Buyers*

Rule 103(G) of the Mississippi Blue Sky Rules defines "institutional investor or buyer," providing the means to expand the list of specific categories coming within the section 75-71-203(8) exemption.<sup>615</sup> Effective January 2, 1991, the Mississippi Secretary of State amended Rule 103(G) to be identical to the then existing definition of "qualified institutional buyer" (QIB) in Rule 144A under the Securities Act.<sup>616</sup> The amendment was consistent with the official endorsement of Rule 144A by the North America Securities Administrators Association, Inc. (NASAA).<sup>617</sup>

---

<sup>614</sup> *Id.*

<sup>615</sup> 2 Blue Sky L. Rep. (CCH) ¶ 34,403, at 29,401-02.

<sup>616</sup> For discussion of the Rule 144A exemption, see *Financing a Small Business (Part I)*, *supra* note 416, at 219-20.

<sup>617</sup> See *Resolution of the North American Securities Administrators Association, Inc., Regarding Transactions in Securities in Reliance on Rule 144A*, NASAA Rep. (CCH) ¶ 7031, at 7039.



QIBs are generally defined under Rule 144A to include the same type of institutions which are included in the non-natural person categories of the "accredited investor" definition under Regulation D,<sup>618</sup> with the additional requirement that the institution must own and invest, on a discretionary basis, a minimum of \$100,000,000 in securities of issuers which are not affiliated with the institution.<sup>619</sup> Broker-dealers are required to have only \$10,000,000 so owned and invested.<sup>620</sup> Banks and savings and loans must have not only \$100,000,000 so owned and invested but must also have a \$25,000,000 net worth.<sup>621</sup>

The Mississippi Securities Act section 75-71-203(8) exemption already covers most of the broad categories of institutional investor and includes transactions by such investors "whether the purchaser is acting for itself or in some fiduciary capacity." The QIB definition not only restricts itself to institutions meeting the portfolio and net worth requirements imposed by Rule 144A but also covers only transactions by an institution "for its own account or the accounts of *other qualified institutional buyers*." Consequently, amending Rule 103(G) to follow the QIB definition does little, if anything, to *expand* the Mississippi institutional exemption. The only real gain might be for a corporation or partnership that met the \$100,000,000 securities portfolio requirement but did not fall into one of the specific section 75-71-203(8) categories. Rule 103(G) eliminates whatever doubt could have existed that such entities are "other . . . institutional buyers" within the meaning

---

<sup>618</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 166-69.

<sup>619</sup> See *id.* at 219.

<sup>620</sup> *Id.*

<sup>621</sup> *Id.* In October 1992, the SEC amended the QIB definition to: (i) include collective and master trusts, two legal forms commonly used for the collective investment of pension and other employee benefit plan funds; (ii) cover purchases by insurance companies for separate accounts not required to be registered under the Investment Company Act; and (iii) permit inclusion of U.S. government securities in calculating the amount of securities owned and invested. See Securities Act Release No. 6963, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,052, at 83,383 (Oct. 28, 1992). Rule 103(G) has not been amended to conform to the October 1992 alterations to the Rule 144A definition of QIB.

of section 75-71-203(8). This sort of clarification is unlikely to have much practical impact on start-up and small business financing in Mississippi.

On the other hand, the 1991 amendment to Rule 103(G) makes it absolutely clear that Mississippi state securities laws will not impede in any way development of the Rule 144A institutional market and that the state is joining in the national effort to respond to institutionalization and globalization of securities markets. In short, the 1991 amendment to Rule 103(G) probably has more political than practical importance. It represents the sort of timely state deference to federal policy in key areas that will be essential to the continued viability of blue sky regulation.<sup>622</sup>

### c. Accredited Investors

A number of states, including Illinois, Iowa, Minnesota and Oregon, have incorporated all or part of the Regulation D definition of "accredited investor" into their institutional exemption equivalents to section 75-71-203(8).<sup>623</sup> Mississippi blue sky law does *not* incorporate the "accredited investor" definition into section 75-71-203(8), but the Securities Division of the office of the Secretary of State has in the past considered proposing such a provision based on recommendations from

---

<sup>622</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 139-41; see also MISS. CODE ANN. § 75-71-103 (1991) (stating that Mississippi securities laws should be construed in manner that promotes uniformity with related federal law).

<sup>623</sup> See, e.g., ILL. ANN. STAT. ch. 815, para. 4(H), (R), (S) (Smith-Hurt 1993); Rules of Iowa Insurance Division — Securities Bureau, 1A Blue Sky L. Rep. (CCH) ¶ 25,446, at 20429; Minnesota Rules — Department of Commerce, Regulation of Securities, 2 Blue Sky L. Rep. (CCH) ¶ 33,407; OR. REV. STAT. § 59.035(5) (1987 & Supp. 1992); OR. ADMIN. R. 441-35-010 (1992), 2A Blue Sky L. Rep. (CCH) ¶ 47,553, at 42,513-2. The Iowa, Minnesota and Oregon exemptions incorporate the entire Regulation D accredited investor definition. The Illinois exemption includes the \$1,000,000 net worth, \$200,000 income and director/officer/general partner categories. The Illinois exemption also includes the old \$150,000 purchaser category which was eliminated from Regulation D in 1988. See *Financing a Small Business (Part I)*, *supra* note 416, at 168-69. Other states have incorporated only the institutional or non-individual portions of the accredited investor definition. See, e.g., 2 Blue Sky L. Rep. (CCH) ¶ 30,432, at 25,419-3 (Code of Maryland Regulation).

practitioners in the state.<sup>624</sup> Nonetheless, the Mississippi Secretary of State has frequently used its authority to issue no-action letters under section 75-71-111(e)<sup>625</sup> of the Mississippi Securities Act to authorize sales in particular offerings to a limited number of Mississippi accredited investors as if the institutional exemption was available.<sup>626</sup>

Unlike inclusion of QIBs in the definition of "other . . . institutional buyer," inclusion of accredited investors would constitute a real expansion of the institutional exemption and would have a real impact on start-up and small business financing. Such a provision would create a totally self-effectuating and unrestricted exemption enabling issuers to offer and sell to officers and directors, venture capital funds, substantial corporate investors as well as individuals having a net worth of at least \$1,000,000 or annual gross income in excess of \$200,000, among other categories.<sup>627</sup> The Illinois and Oregon provisions are conditioned on absence of general solicitation and advertising.<sup>628</sup> The Iowa, Maryland and Minnesota provisions have no such restrictions.<sup>629</sup>

*d. Residual Content of "Institutional Buyer"*

The Mississippi Secretary of State does not appear to have the statutory authority to restrict (as opposed to expand) any of the specific or generic categories of institutional investor in

---

<sup>624</sup> Telephone Interview with Michael Henry, Securities Division, Mississippi Secretary of State (Feb. 23, 1993).

<sup>625</sup> See *supra* notes 609-11 and accompanying text.

<sup>626</sup> Telephone Interview with Michael Henry, Securities Division, Mississippi Secretary of State (Mar. 17, 1993); see, e.g., Northfield Labs., Inc., Miss. Sec. of State Opinion Letter, Apr. 8, 1993; Dixie Nat'l Corp., Miss. Sec. of State Opinion Letter, Mar. 24, 1993; Williamsburg Investors, L.P., Miss. Sec. of State Opinion Letter, Feb. 19, 1993; Arbor Partners, L.P., Miss. Sec. of State Opinion Letter, Oct. 6, 1992; Intelligent Computer Music Sys. Inc., Miss. Sec. of State Opinion Letter, July 15, 1991; Sandoz Crop Protection, L.P., Miss. Sec. of State Opinion Letter, Nov. 14, 1990; York Acquisitions Corp., Miss. Sec. of State Opinion Letter, Sept. 27, 1990; Collision Ctrs. Int'l, Inc., Miss. Sec. of State Opinion Letter, Jan. 4, 1990.

<sup>627</sup> For a comprehensive discussion of the accredited investor definition, see *Financing a Small Business (Part I)*, *supra* note 416, at 166-73.

<sup>628</sup> See *supra* note 623 and accompanying text.

<sup>629</sup> *Id.*



section 75-71-203(8). Therefore, Rule 103(G) should not be viewed as narrowing, or limiting in any way, the statutory exemption. This means that the statutory catch-all — “or other financial institution or institutional buyer” — should be viewed as having residual content beyond the QIB definition specified in Rule 103(G). The nonrestrictive and nonexclusive nature of Rule 103(G) is made clear by its introductory language — “shall include but not be limited to.”<sup>630</sup>

## 2. *Limited Offering Exemption: Section 75-71-203(9)*

Section 75-71-203(9) provides a limited offering exemption (based on section 402(b)(9) of the Uniform Act)<sup>631</sup> for sales by an issuer to not more than 10 persons, whether residents or non-residents, during any twelve-month period. The exemption is only available if all of the following conditions are met:

(1) *Investment Intent*. The seller must “reasonably believe” that all of the buyers are purchasing for investment purposes only.<sup>632</sup> Neither section 75-71-203(9) nor the Mississippi Blue Sky Rules indicate what backup is necessary to support a “reasonable belief.” Certainly, the steps which conclusively demonstrate “reasonable care” to assure that purchasers are not underwriters under Rule 502(d) of Regulation D (*i.e.*, reasonable inquiry, written disclosure of restrictions on resale and legending of certificates) should be sufficient for purposes of section 75-71-203(9).<sup>633</sup> Even Rule 502(d) no longer requires that all such steps be taken to satisfy the comparable conditions in Regulation D.<sup>634</sup> Prudent issuers relying on the Mississippi

---

<sup>630</sup> Cf. LOSS, *supra* note 608, at 123 (stating that “[t]he term ‘institutional buyer’ is broad enough to cover, for example, a college purchasing for its endowment fund or perhaps a labor union investing its surplus funds on a substantial scale”).

<sup>631</sup> 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1557-62.

<sup>632</sup> An express one-year limitation on transferability imposed on shares sold under § 75-71-203(9) by rule was eliminated in January 1990. For a discussion of the comparable limitation on resale in Regulation D under the Securities Act, see *Financing a Small Business (Part I)*, *supra* note 416, at 213-20.

<sup>633</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 213-20.

<sup>634</sup> See *id.* at 216-17.

exemption, however, should continue to legend certificates and obtain representations of investment intent.<sup>635</sup>

(2) *No Commissions; Offers by Officers, General Partners or Registered Broker-Dealers Only.* No commission or remuneration may be paid or given directly or indirectly for soliciting any prospective buyer. Offers and sales may only be made by officers of the issuer or by the general partners of a limited partnership or a broker-dealer registered under the Mississippi Securities Act.<sup>636</sup> None of the relevant federal exemptions have a comparable condition concerning who makes the offers or payment of commissions.

(3) *No General Solicitation or Advertising.* No general solicitation or advertising may be used in any such transaction.<sup>637</sup> Undoubtedly, Regulation D concepts of general solicitation and advertising will shape the state law prohibition.

(4) *No Notice.* A notice filing requirement for the section 75-71-203(9) exemption was eliminated by the Mississippi Legislature in 1987.<sup>638</sup> The exemption is now totally self-effectuating or "self-actuating" in the words of the Mississippi Blue Sky Rules.<sup>639</sup>

(5) *Waivers & Other Conditions.* The Mississippi Secretary of State has express statutory authority to withdraw or waive (but not to add) conditions to the section 75-71-203(9) exemption. Requests for waivers have generally not been successful.<sup>640</sup> In one case, however, the Secretary of State granted a

---

<sup>635</sup> See *id.* at 215-16. Such steps should not, however, be rigidly required in order to establish a "reasonable belief."

<sup>636</sup> Even where a registered broker-dealer sells the securities, however, no commission may be paid. An overall expense limitation requirement imposed on § 75-71-203(9) offerings by rule was eliminated in January 1990.

<sup>637</sup> For a discussion of the comparable prohibition on general solicitation and advertising in Regulation D under the Securities Act, see *Financing a Small Business (Part I)*, *supra* note 416, at 204-13.

<sup>638</sup> See 1987 Miss. Laws ch. 477, § 4.

<sup>639</sup> See Mississippi Blue Sky Rule 701, 2 Blue Sky L. Rep. (CCH) ¶ 34,521, at 29,422.

<sup>640</sup> See Concord Growth Corp., Miss. Sec. of State Opinion Letter, Feb. 24, 1989 (denying waivers of no-commission and 10-investor limitations in offering to accredited investors); Concord Growth Corp., Miss. Sec. of State Opinion Letter, Jan. 11, 1988 (denying request for general waiver of conditions).

waiver of the no-commission provision where an issuer was selling 50% of its stock to two businessmen.<sup>641</sup>

*a. Background*

A self-effectuating exemption for offers and sales to a limited number of persons is extremely important to any blue sky regulatory framework designed to provide adequately for start-up and small business financing.<sup>642</sup> The exemption provides the basis for initial share issuances at incorporation and for raising additional capital from a few relatives and friends "without going through registration or — as is more likely today — violating the statute in complete oblivion of the possibility that anything like a blue sky law might be applicable."<sup>643</sup>

Both of the other significant non-institutional exemptions under the Mississippi Securities Act (the Mississippi Uniform Limited Offering Exemption in Rule 703 and the domestic issuer limited offering exemption in Rule 705) require a notice filing prior to receipt of proceeds as an absolute condition to availability of the exemption.<sup>644</sup> Therefore, section 75-71-203(9) plays a crucial role with respect to start-up and small business financing in Mississippi. It is the only exemption from registration that the untutored and the uncounselled have available.<sup>645</sup>

---

<sup>641</sup> Sabre Indus., Inc., Miss. Sec. of State Opinion Letter, Jan. 16, 1991. For additional letters confirming the availability of the exemption without explicit waiver, see Union Compress Warehouse Co. of Vicksburg, L.P., Miss. Sec. of State Opinion Letter, Sept. 7, 1988; ROMAXSCO Exploration Co., Miss. Sec. of State Opinion Letter, Sept. 14, 1987.

<sup>642</sup> See LOSS, *supra* note 608, at 123.

<sup>643</sup> *Id.*

<sup>644</sup> See *infra* notes 679-83, 690-91 and accompanying text.

<sup>645</sup> Availability of the exemption to the untutored and uncounselled could be limited by a strict interpretation that "reasonable belief" of investment intent required that all certificates be legended and all investors receive relevant disclosures or give investment representations. Such a strict interpretation would be inconsistent with the approach now taken in Regulation D and would be inappropriate given the unique role played by § 75-71-203(9) of the Mississippi Code in the overall exemptive structure. See *supra* notes 633-34 and accompanying text.



Almost all states provide some form of self-effectuating limited offering exemption.<sup>646</sup> Some are self-effectuating, others are conditioned on notice filing.<sup>647</sup> Some limit the offering in terms of the number of offers, others in terms of the number of sales or purchasers and yet others in terms of the number of shareholders after the exempt transactions are consummated.<sup>648</sup> The Mississippi provision limits *sales* rather than *offers*, but provides a governor on offers by adding an express prohibition on general advertising or solicitation, which is not contained in section 402(b)(9) of the Uniform Act. Also, section 75-71-203(9) of the Mississippi Securities Act counts residents as well as non-residents against the ten-purchaser limit (a restriction found in comparable exemptions in some other states, but not in section 402(b)(9) of the Uniform Act).<sup>649</sup>

The provision requiring that offers and sales be made exclusively by officers or general partners of the issuer or

---

<sup>646</sup> LOSS, *supra* note 608, at 125; JENNINGS, MARSH, & COFFEE, *supra* note 381, at 1637.

<sup>647</sup> See, e.g., MINN. STAT. § 80A.15(2)(h)(1986), 2 Blue Sky L. Rep. (CCH) ¶ 33,115, at 28,112-15 (pre-sale notice requirement); NEB. REV. STAT. § 8-1111(9) (1993), 2 Blue Sky L. Rep. (CCH) ¶ 37,114, at 32,120-22 (post-sale notice requirement).

<sup>648</sup> See, e.g., ME. REV. STAT. ANN. tit. 32 § 10502(2)(P), 2 Blue Sky L. Rep. (CCH) ¶ 29,072, 24,121 (no more than ten shareholders after transaction); MASS. GEN. L. ch. 110A, § 402(b)(9) (1984), 2 Blue Sky L. Rep. (CCH) ¶ 31,132, 26,110-12 (offers to no more than 25 persons); MINN. STAT. § 80A.15(2)(h) (1986), 2 Blue Sky L. Rep. (CCH) ¶ 33,115, at 28,115 (sales to no more than 25 persons); MO. REV. STAT. § 409.402(b)(9) (1986), 2 Blue Sky L. Rep. (CCH) ¶ 35,114, at 30,115 (no more than 25 shareholders after transaction).

<sup>649</sup> Section 402(b)(9) covers "any transaction pursuant to an offer directed by the offeror to not more than 10 persons (other than those designated [in the institutional exemption]) in this state during any period of [12] consecutive months, whether or not the offeror or any of the offerees is then present in the state." Uniform Securities Act § 402(b)(9), 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1559. An issuer could direct an offer to 10 Mississippians, 5 Louisianans and 7 Alabamans and sell to all the Mississippians in reliance on § 402(b)(9) regardless of how many non-residents purchased (assuming all the other conditions of the exemption were met). Availability of § 75-71-203(9) of the Mississippi Code for the same offering would depend on how many total sales resulted. Sales to non-residents reduce the availability of the exemption for Mississippians. For example, if the issuer sold to 1 Mississippian and no more than 9 non-residents, the exemption would be available (assuming all the other conditions of the exemption were met). If the issuer sold to 1 Mississippian and 10 non-residents, the exemption would be unavailable.

registered broker-dealers is also not contained in section 402(b)(9). This limitation appears to be intended to restrict the marketing of limited offerings to those most intimately knowledgeable of the issuer, those most directly responsible for the issuer as well as registered intermediaries. While such a restriction does have some link to investor protection, preventing non-officer directors or promoters from marketing a limited offering seems overly protective.

*b. Counting Rules*

Unlike Regulation D, section 75-71-203(9) of the Mississippi Securities Act does not prescribe any rules for counting the ten purchasers. Section 402(b)(9) under the Uniform Act at least specifies that persons covered by the institutional exemption do not count against the ten purchasers per twelve months available under section 75-71-203(9).<sup>650</sup> However, there is no such clarification in the Mississippi Securities Act, leaving issuers and their counsel to wonder. It is also not entirely clear whether the sales to ten persons per year under the section 75-71-203(9) exemption are *in addition to* the other limited offering exemptions under the Mississippi Securities Act. For example, does an issuer having made sales to thirty-five persons pursuant to the domestic issuer limited offering exemption in Rule 705 of the Mississippi Blue Sky Rules still have ten more exempt sales to make under the section 75-71-203(9) exemption?<sup>651</sup>

It is also not clear: (1) whether relatives of a purchaser or corporations or trusts related to a purchaser count against the ten when they co-invest with the purchaser; and (2) whether entities count as one purchaser or there is a look-through to their equity holders.<sup>652</sup> The domestic limited offering exemp-

---

<sup>650</sup> 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1559. In many other states, the limited offering exemptions provide the same cross-reference. *See, e.g.*, MINN. STAT. § 80A.15(2)(h) (1986), 2 Blue Sky L. Rep. (CCH) ¶ 33,115; NEB. REV. STAT. § 8-1111(9) (1993), 2 Blue Sky L. Rep. (CCH) ¶ 37,114, at 32,121.

<sup>651</sup> *See infra* notes 713-19 and accompanying text.

<sup>652</sup> For a discussion of the Regulation D rules with respect to such counting, see *Financing a Small Business (Part I)*, *supra* note 416, at 175-76.

tion in Rule 705 of the Mississippi Blue Sky Rules has some counting provisions on these points, but their application to the section 75-71-203(9) exemption is not clear.<sup>653</sup> However, in at least one request for interpretation, the Secretary of State has confirmed that a husband and wife purchasing jointly should be considered one purchaser for purposes of section 75-71-203(9) (a position consistent with Regulation D and Rule 705(g)(2) of the Mississippi Blue Sky Rules).<sup>654</sup>

*c. Exemption for Preorganization Certificates or  
Subscriptions: Section 75-71-203(10)*

Section 75-71-203(10) of the Mississippi Securities Act provides an exemption from registration for:

Any offer or sale of a preorganization certificate or subscription if (A) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (B) the number of subscribers does not exceed thirty-five (35), and (C) no payment is made by any subscriber.<sup>655</sup>

Although this section might appear to be helpful in start-up financing, it covers *only* preorganization subscriptions and *not* the offers and sales resulting from them.<sup>656</sup> Section 75-71-203(10) of the Mississippi Securities Act was modeled on section 402(b)(10) of the Uniform Act which was intended to provide an exemption for the solicitation of subscriptions necessary to provide the minimum capital required for incorporation under state corporation statutes.<sup>657</sup> The exemption does not eliminate the need for registration or another exemption for the actual sale of stock, it only postpones the need for such registration or other exemption.<sup>658</sup> Since the Mississippi

---

<sup>653</sup> See *infra* notes 692-94 and accompanying text; MISS. CODE ANN. § 75-71-105(i) (1991) (defining "person" under Mississippi Securities Act).

<sup>654</sup> See Mississippi Blue Sky Rule 705, 2 Blue Sky L.Rep. (CCH) ¶ 34,523, at 29,424-25; James R. Thomas, IV, Miss. Sec. of State Opinion Letter, Oct. 12, 1988; see also *Financing a Small Business (Part I)*, *supra* note 416, at 176.

<sup>655</sup> MISS. CODE ANN. § 75-71-203(10) (1991).

<sup>656</sup> LOSS, *supra* note 608, at 130-31.

<sup>657</sup> *Id.* at 130.

<sup>658</sup> *Id.*



Business Corporation Act and most other state corporation statutes no longer have minimum capital requirements, the section 75-71-203(10) exemption is of little practical value.<sup>659</sup>

### 3. *Uniform Limited Offering Exemption: Rule 703*

#### a. *Background*

Concerned with the disparity between federal and state exemptions, Congress mandated a cooperative effort between the SEC and NASAA to develop a uniform state and federal exemptive scheme in the Small Business Investment Incentive Act of 1980.<sup>660</sup> The SEC responded by adopting Regulation D in March 1982.<sup>661</sup> To coordinate the new Regulation D exemptions with state exemptions, NASAA adopted a final version of the Uniform Limited Offering Exemption (ULOE) in September 1983.

Since NASAA is a voluntary organization of state securities regulators with no power to force states to comply with its uniform law proposals, each state has complete autonomy in accepting, rejecting or modifying NASAA recommendations. Since 1983, more than thirty-five states have adopted some form of ULOE or ULOE-based exemption.<sup>662</sup> Few states, however, have adopted the uniform exemption in unadulterated

---

<sup>659</sup> Cf. Cook & Smith, *supra* note 598, at 1010-12 (discussing preorganization subscriptions under predecessors to current Mississippi Business Corporation Act and current Mississippi Securities Act).

<sup>660</sup> Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275; see Securities Act § 19(c), 15 U.S.C. § 77s(c) (1988). The North American Securities Administrators Association, Inc. is an organization comprised of securities regulators from 65 jurisdictions located in the United States, Puerto Rico, Canada and Mexico. Membership is voluntary. NASAA is not a regulatory organization. It has no mandatory powers over its members. NASAA promulgates uniform law provisions and forms for guidance of its members, however, and issues statements of policy and resolutions that have significant influence on what members do. Such materials are collected in the Commerce Clearing House looseleaf service *NASAA Reports*. For an overview of NASAA's other activities, see NASAA Rep. (CCH) ¶¶ 4-6, at 12-16.

<sup>661</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 142.

<sup>662</sup> See JENNINGS, ET AL., *supra* note 381, at 1639. A chart outlining the limited offering exemptions available in the various U.S. jurisdictions is set forth at 1 Blue Sky L. Rep. (CCH) ¶ 6251 at 2357-59.

form. In addition, the amendments made to ULOE since its adoption — primarily to accommodate changes in Regulation D — have provided individual states with further opportunity to tinker. The result has been a continuing lack of uniformity that has contributed to growing criticism of the two-tiered system of securities regulation in the United States and concern about the competitiveness and efficiency of over-regulated U.S. capital markets in the global economy of the 1990s and beyond.<sup>663</sup>

*b. Standard ULOE*

NASAA's standard ULOE exempts from state securities law registration requirements offers and sales which are exempt under Regulation D for federal purposes. The standard ULOE incorporates only the Rule 505 exemption but gives states the option of also covering Rule 506. ULOE was never intended to cover the Rule 504 exemption since Rule 504 was designed to operate at the federal level as a complete delegation of regulatory responsibility to the states. Consequently, the standard ULOE then adds certain additional requirements and conditions to the terms of Regulation D that it incorporates:

(1) *Commissions*. Regulation D imposes no conditions or requirements relating to payment of commissions or fees. However, under standard ULOE, no commission, fee or remuneration may be paid except to a broker-dealer appropriately registered in the particular state or a person the issuer reasonably believes to be so registered.<sup>664</sup>

---

<sup>663</sup> See Breeden *Calls for Unified Market to Meet Overseas Competitive Challenge*, 22 Sec. Reg. & L. Rep. (BNA) 351 (Mar. 9, 1990); *State Regulation Not Impediment to Globalization, NASAA Gathering Told*, 22 Sec. Reg. & L. Rep. (BNA) 1315 (Sept. 14, 1990). See generally Ronald L. Fein, et al., *ULOE: Comprehending the Confusion*, 43 BUS. LAW. 737 (1988); Mark A. Sargent & Hugh H. Makens, *ULOE: New Hope, New Challenge*, 45 BUS. LAW. 1319 (1990).

<sup>664</sup> NASAA Rep. (CCH) ¶ 6201, at 6,101. Paragraph 1(a) of ULOE goes on to provide a "due diligence defense" for issuers by providing that:

It is a defense to a violation of this subsection if the issuer sustains the burden of proof to establish that he or she did not know and in the exercise of reasonable care could not have known that the person who received a commission, fee or remuneration was not appropriately registered in the state.

*Id.*

(2) *"Bad Boy" Disqualifiers.* As discussed in Part I, issuer eligibility for Rule 505 of Regulation D is subject to the "bad boy" disqualification provisions of Rule 262 of Regulation A.<sup>665</sup> An issuer subject to one or more "bad boy" disqualifying events (arising primarily under federal laws) is not permitted to rely on Rule 505 unless the SEC grants a waiver. Standard ULOE has its own additional set of "bad boy" disqualifiers covering much of the same ground as the Rule 505 disqualifiers, but it also covers additional state law offenses and events.<sup>666</sup> The ULOE disqualifiers are applicable not only to offers and sales, purportedly exempt under Rule 505, but also to those purportedly exempt under Rule 506--to the extent the particular state has included Rule 506 in its ULOE coverage. The particular items included in the ULOE "bad boy" disqualifiers have been one of the areas of greatest non-uniformity among states adopting the exemption.<sup>667</sup> Also, standard ULOE creates a "due diligence defense" for issuers by providing that "[i]t is a defense to a violation of this subsection if issuer sustains the burden of proof to establish that he or she did not know and in the exercise of reasonable care could not have known that a disqualification . . . existed."<sup>668</sup>

(3) *Suitability Standards for Non-accredited Investors.* Standard ULOE requires compliance, or a reasonable belief of compliance on the part of the issuer, with certain suitability conditions for all *non-accredited* investors in the particular state. The investment must either be suitable, based on the purchaser's other holdings, financial situation and needs — with suitability being presumed where the investment does not

---

<sup>665</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 157-58.

<sup>666</sup> See NASAA Rep. (CCH) ¶ 6201, at 6,101-03. Therefore, an offering made in reliance on Rule 505 for federal purposes, and a ULOE-based exemption, for state purposes, must pass scrutiny under two sets of bad-boy provisions.

The reference in Paragraph 1(B) of ULOE to Rule 252 under the Securities Act must be changed to Rule 262 to conform to the revamping of Regulation A in the Small Business Initiatives. See *Financing a Small Business (Part I)*, *supra* note 416, at 143 n.32.

<sup>667</sup> See *Fein, et al.*, *supra* note 663, at 745-46; *Sargent & Makens*, *supra* note 663, at 1326-27.

<sup>668</sup> NASAA Rep. (CCH) ¶ 6201, at 6,103.



exceed ten percent of net worth<sup>669</sup> — or the purchaser must, either alone or with a purchaser representative, have such knowledge and experience in financial matters that he is capable of evaluating the merits and risks of the prospective investment.<sup>670</sup>

(4) *Notice.* As an absolute condition to availability of the exemption, standard ULOE requires that the issuer file a notice on Form D with the particular state securities administrator before receipt of consideration and delivery of a subscription agreement by an investor. Post-sale filing is an alternative variant,<sup>671</sup> and a number of states have adopted such a requirement.<sup>672</sup> Rule 503(a) now requires only a post-sale filing for purposes of Regulation D.<sup>673</sup> Furthermore, after the 1989 amendments to Regulation D, the post-sale filing is no longer an absolute condition to the Regulation D exemptions.<sup>674</sup> In addition to maintaining filing as a condition, standard ULOE requires an undertaking by the issuer to provide disclosure documents to the particular state securities administrator, filing of a consent to service of process and payment of a filing fee to be set by the particular state.

(5) *Substantial Compliance.* The 1989 amendments to Regulation D added new Rule 508 which provides that failure to comply with a term, condition or requirement of a Regulation D exemption will not result in loss of the exemption with respect to any particular investor if: (a) the failure to comply

---

<sup>669</sup> Federal and state definitions of "net worth" may vary. The federal definition for purposes of Regulation D includes fair market value of investor's home, home furnishings and automobiles in the calculation. These items may be excluded under particular state laws. See *Financing a Small Business (Part I)*, *supra* note 416, at 170.

<sup>670</sup> This second alternative suitability condition is the Rule 506 purchaser qualification standard which is presumed for Regulation D purposes in the case of accredited investors. See *Financing a Small Business (Part I)*, *supra* note 416, at 160.

<sup>671</sup> See NASAA Rep. (CCH) ¶ 6,201, at 6,104 n.4 (stating that "[i]n those states where facts and circumstances permit, it would not be inconsistent with the regulatory objectives of this exemption for a state to consider a post-sale notice patterned after the notice provisions of Regulation D").

<sup>672</sup> See Fein, et al., *supra* note 663, at 749.

<sup>673</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 220-22.

<sup>674</sup> See Sargent & Makens, *supra* note 663, at 1328-29 (recommending revision of standard ULOE to follow Regulation D approach).

did not pertain to a provision intended to protect that particular investor; (b) the failure to comply was insignificant with respect to the offering as a whole; and (c) a good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements.<sup>675</sup> Such a failure to comply remains actionable in an enforcement proceeding. Rule 508, insofar as it relates to the provisions of Regulation D, is in effect incorporated by reference into ULOE. However, standard ULOE has an identical substantial compliance provision to cover the additional requirements imposed by ULOE relating to commissions, suitability and notice filing.<sup>676</sup> The standard ULOE substantial compliance provision does *not* apply to the ULOE "bad boy" disqualifiers.<sup>677</sup>

*c. Mississippi ULOE*

In 1987, pursuant to the authority granted in section 75-71-203(13), the Secretary of State adopted a version of ULOE as Rule 703 of the Mississippi Blue Sky Rules. Rule 703 of the Mississippi Blue Sky Rules is a standard ULOE provision with the addition of a Rule 506 option. The Mississippi ULOE exempts offers and sales that are part of an offering in compliance with "[Rule 505] and/or [Rule 506], and any amendments thereto."<sup>678</sup> Rule 703 therefore captures all existing amendments to Regulation D, and future amendments will be automatically incorporated by reference. The standard ULOE

---

<sup>675</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 223-26.

<sup>676</sup> See NASAA Rep. (CCH) ¶ 6201, at 6101-03. Coverage of the notice filing requirement is presented as an optional alternative with the following note:

In those states which have adopted a post-sale notice patterned after the notice provisions of Regulation D . . . it would not be inconsistent with the regulatory objectives of this exemption to include the notice filing requirements . . . within the substantial compliance provisions . . . or to eliminate the filing as a condition and adopt a rule similar to [Rule 507 of Regulation D].

*Id.* at 6105 n.6.

<sup>677</sup> See Sargent & Makens, *supra* note 663, at 1321-27 (recommending revision of standard ULOE to make substantial compliance applicable to "bad boy" disqualification).

<sup>678</sup> 2 Blue Sky L. Rep. (CCH) ¶ 34,522, at 29,422. Like standard ULOE, Rule 703 is *not* available for an offering exempt under Rule 504 of Regulation D (unless such offering is also exempt under Rule 505 or 506).

substantial compliance provision discussed above was added to Rule 703 in January 1990.

The commission payment, disqualification, suitability and notice requirements of Mississippi's ULOE all track the provisions of standard ULOE, with two notable exceptions. First, the "bad boy" disqualification provisions in Rule 703 do not contain the standard ULOE due diligence defense discussed above. Without the due diligence defense or coverage under the substantial compliance provision, the Rule 703 disqualification provision is absolute unless waived. Second, Mississippi's notice provision is more burdensome than standard ULOE. Instead of requiring only an undertaking to provide disclosure documents to the state securities administrator upon request, Rule 703 requires actual filing with the Secretary of State of the "prospectus, private placement memorandum, offering circular or similar document to be furnished by the issuer to offerees" along with the Form D, consent to service and a \$300 fee. The filing under Rule 703 must be made prior to receipt of consideration or the delivery of a subscription agreement.<sup>679</sup>

Further, Rule 703 requires the issuer to file a notice of termination within thirty days of completion of the offering and an annual notice in offerings which continue for more than one year.<sup>680</sup> Finally, Rule 703 specifically prohibits any sales until a written "Acknowledgement of Notice Filing" has been issued by the Securities Division of the Mississippi Secretary of State, adding another non-uniform administrative condition to the exemption.<sup>681</sup>

The Rule 703 filing requirement is subject to the substantial compliance provision. It is, however, far from clear how the substantial compliance provision would operate with respect to something of an apparently all-or-none nature like a filing requirement.<sup>682</sup> Since there must be a "good faith and reason-

---

<sup>679</sup> 2 Blue Sky L. Rep. (CCH) ¶ 34,522 at 29,423.

<sup>680</sup> *Id.* at 29,424.

<sup>681</sup> *Id.*

<sup>682</sup> This seems to be the reason that standard ULOE suggests exclusion of the full-bore filing requirement from the substantial compliance provision. See *supra* note 677. This also appears to be the reason the SEC did not rely on the Rule 508 substantial



able attempt to comply," would the substantial compliance provision help the uncounseled issuer that is oblivious to the requirement? Would it only aid those who actually put something in the mail? Those who make at least one required filing? When is failure to file "insignificant with respect to the offering as a whole?"<sup>683</sup>

#### 4. *Domestic Issuer Limited Offering Exemption: Rule 705*

##### a. *Conditions*

Rule 705 of the Mississippi Blue Sky Rules provides an additional limited offering exemption for issuers organized in Mississippi (e.g., Mississippi corporation or limited partnership) which sell their securities to thirty-five or fewer purchasers, whether residents or non-residents, during any twelve-month period.<sup>684</sup> The exemption is only available if all of the following conditions are met:

(1) *Investment Intent*. The issuer must "reasonably believe" that all the buyers are purchasing for investment purposes only.<sup>685</sup> In addition, Rule 705(H) provides that securities

---

compliance concept to relieve the rigidity of the old Form D filing requirement. See *Financing a Small Business (Part I)*, *supra* note 416, at 223-26; see also *infra* note 683 and accompanying text.

<sup>683</sup> The SEC, in adopting Rules 507 and 508, in effect divided the requirements for Regulation D into three categories of significance: (1) the prohibition on general solicitation and advertising and the dollar and purchaser numerical limits are excluded from Rule 508 because they are *always* significant to the offering as a whole; (2) the Form D filing requirement can never result in the loss of an exemption, making it in effect *never* significant to the offering as a whole; and (3) everything else may or may not be significant to the offering as a whole depending on the circumstances. The implication to be drawn from inclusion of the filing requirement in the Mississippi substantial compliance provision is that sometimes strict compliance is significant, and sometimes it is not. See *infra* notes 737-38 and accompanying text (proposing that filing requirement be amended to conform to approach in Rules 503 and 507 of Regulation D).

<sup>684</sup> 2 Blue Sky L. Rep. (CCH) ¶ 34,523, at 29,424. Rule 705 was based on a similar statutory exemption contained in § 75-71-203 of the Mississippi Securities Act until 1987.

<sup>685</sup> For a discussion of the comparable limitation on resale and a discussion of the meaning of "reasonable belief" under Regulation D, see *Financing a Small Business (Part I)*, *supra* note 416, at 213-20.

issued under the Rule 705 exemption may not be transferred for a period of one year from the date of purchase except in exempt transactions or in a transaction in compliance with the registration requirements of the Mississippi Securities Act.<sup>686</sup>

(2) *Legend.* A prescribed legend must appear on the private placement memorandum or other disclosure documents used in connection with the offering.<sup>687</sup>

(3) *No Commissions; Offers by Officers, General Partners or Registered Broker-Dealers Only.* No commission or remuneration may be paid without the prior approval of the Securities Division of the Secretary of State. Offers and sales may only be made by officers of the issuer or by the general partner of a limited partnership or a broker-dealer registered under the Mississippi Securities Act.<sup>688</sup>

---

As in the case of the § 75-71-203(9) limited offering exemption, Rule 705 does not specify the backup required to substantiate "reasonable belief" of investment intent. For a discussion of reasonable interpretations, see *supra* notes 633-35 and accompanying text. A specified legend referring to restrictions on resale (among other things) must be printed on the private placement memorandum or other disclosure documents as a separate requirement of Rule 705. See *supra* note 634 and accompanying text.

<sup>686</sup> This statement appears to be nothing more than a confirmation of the basic registration requirement under the Mississippi Securities Act: all sellers of securities must either register or comply with an exemption. See *Financing a Small Business (Part I)*, *supra* note 416, at 134 n.3. This truism applies during the year after issuance and continues to apply thereafter. Consequently, it is hard to understand exactly what Rule 705(H) means. Is it mere surplusage? How does the period after one year differ from the period before? Does it mean that sellers of securities resold more than one year after a Rule 705-exempt issuance need not worry about registration or exemption? This last suggestion is unlikely.

The Mississippi Code § 75-71-203(1) provision for isolated non-issuer transactions and the § 75-71-203(8) provision for institutional transactions provide ample exemptive room for most private resales of securities acquired in start-up or small business financing. For a brief discussion of the federal exemptions for resale, see *Financing a Small Business (Part I)*, *supra* note 416, at 217-20.

<sup>687</sup> Rule 705(E), 2 Blue Sky L. Rep. (CCH) ¶ 34,523, at 29,424. Verbatim compliance with the legend requirement is apparently an absolute condition for availability of the exemption. Rule 705 has no substantial compliance provision like Rule 703.

<sup>688</sup> These two conditions appear to be effectively the same as under the § 75-71-203(9) exemption. See *supra* note 636 and accompanying text.

(4) *No General Solicitation or Advertising.* No general solicitation or general advertising may be used to offer or sell the securities.<sup>689</sup>

(5) *Notice.* Rule 705 requires the filing of a notice, a copy of the private placement memorandum or other disclosure document to be used and a \$300 fee prior to the receipt of consideration or delivery of a subscription agreement by an investor.<sup>690</sup> Like Rule 703, Rule 705 goes on to require a notice of termination (to be filed within thirty days of completion of the offering) and an annual notice (to be filed in offerings which continue more than one year). Also, Rule 705 also prohibits sales until a written Acknowledgement of Notice Filing has been issued by the Securities Division of the Secretary of State.<sup>691</sup>

#### *b. Counting Rules*

Rule 705 prescribes certain rules for counting the thirty-five purchasers permitted per twelve-month period. As under Regulation D,<sup>692</sup> a corporation, partnership or other entity counts as one investor unless organized for the specific purpose of acquiring the securities offered, in which case each beneficial owner of equity interest in the entity counts as a separate purchaser.<sup>693</sup> Rule 705 also specifies that a husband and wife purchasing jointly are deemed to be one investor, but does not

---

<sup>689</sup> For a discussion of the comparable prohibition on general solicitation and advertising in Regulation D under the Securities Act, see *Financing a Small Business (Part I)*, *supra* note 416, at 204-12.

<sup>690</sup> 2 Blue Sky L. Rep. (CCH) ¶ 34,523, at 29,424. The notice requirement is identical to that under the Rule 703 ULOE, except that the ULOE notice is subject to substantial compliance and Rule 705 has no substantial compliance provision. See *supra* notes 679-83 and accompanying text. Strict compliance with the notice requirement is therefore apparently an absolute condition to availability of the Rule 705 exemption.

<sup>691</sup> *Id.* at 29,425

<sup>692</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 174 n.174.

<sup>693</sup> 17 C.F.R. § 230.501(e)(2) (1993). Rule 705(G) also provides that the original limited partner who purchases an interest for the purpose of forming a limited partnership (and whose interest will be extinguished following the offering of partnership units), does not count against the number of investors who may purchase in a Rule 705 offering. 2 Blue Sky L. Rep. (CCH) ¶ 34,523, at 29,425.



cover co-investment by other related individuals, corporations or trusts as in Regulation D.<sup>694</sup>

### 5. Other Exemptions

#### a. Existing Security Holders Exemption: Section 75-71-203(11)

Section 75-71-203(11) of the Mississippi Securities Act exempts from registration:

Any transaction pursuant to an offer to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, nontransferable warrants, or transferable warrants exercisable within not more than [ninety] days of their issuance, if (A) no commission or other remuneration (other than a standby commission) is paid or given directly or indirectly for soliciting any security holder in this state, or (B) the issuer first files a notice specifying the terms of the offer and the Secretary of State does not by order disallow the exemption within the next [ten] full business days.<sup>695</sup>

The exemption tracks section 402(b)(11) of the Uniform Act<sup>696</sup> which was included to provide a means for issuers to fulfill preemptive rights obligations and perform rights offerings, exchange offers and other similar transactions directed solely at existing shareholders as such.<sup>697</sup>

---

<sup>694</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 175-76.

<sup>695</sup> MISS. CODE ANN. § 75-71-203(11) (1991).

<sup>696</sup> See 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1559. The only difference is that the Uniform Act provision gives the state administrator only five business days to disallow reliance on the exemption following notice by the issuer.

<sup>697</sup> For example, one commentator has stated:

Some exemption along these lines is essential — perhaps even constitutionally so under the commerce clause — in order to accommodate corporations whose stockholders have preemptive rights. Today such a corporation is sometimes in the unenviable position of ignoring either its stockholders' preemptive rights or some of the blue sky laws which have no suitable exemption.

LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW, 376-77 (1958). Neither § 75-71-203(11) nor the analogous Uniform Act provision says "solely" to existing security holders. However, Professor Loss' commentary, coupled with the language of the provision and the transactional nature of the exemption, would appear to prevent

Beyond preemptive-rights-type transactions, the Mississippi Secretary of State has confirmed availability of the section 75-71-203(11) exemption for an exchange of new notes for a class of old notes,<sup>698</sup> an exchange of new warrants for an issue of old warrants,<sup>699</sup> conversion of a savings and loan from mutual to stock forms,<sup>700</sup> dividend reinvestment plans,<sup>701</sup> the spin-off of a subsidiary through a stock dividend distribution,<sup>702</sup> as well as a variety of other comparable transactions.<sup>703</sup>

---

reliance on it for sales to existing security holders that resulted from an offer made to investors generally or from any offer not directed at security holders as such. *Accord* Parsons, *supra* note 610, at 190. The Mississippi Secretary of State has confirmed availability of the § 75-71-203(11) exemption to a wide variety of transactions, but an offer solely to security holders as such has been a common feature in the interpretive opinions issued to date. *See infra* notes 698-703 and accompanying text.

<sup>698</sup> Bucyrus-Erie Co., Miss. Sec. of State Opinion Letter, Sept. 14, 1988.

<sup>699</sup> Walker Energy Partners, Miss. Sec. of State Opinion Letter, Dec. 31, 1987.

<sup>700</sup> Franklin First Fin. Corp., Miss. Sec. of State Opinion Letter, June 3, 1988; Winston Sav. and Loan Co., Cincinnati, Ohio, Miss. Sec. of State Opinion Letter, Apr. 29, 1988; Haywood Sav. and Loan Ass'n, Miss. Sec. of State Opinion Letter, Oct. 14, 1987.

<sup>701</sup> Krupp Gov't Income Trusts I and II, Miss. Sec. of State Opinion Letter, Mar. 5, 1993; Benham Capital Mgmt. Group, Miss. Sec. of State Opinion Letter, July 25, 1988; Citizens and S. Georgia Corp., Miss. Sec. of State Opinion Letter, Mar. 12, 1986.

<sup>702</sup> Texas Am. Group, Inc., Miss. Sec. of State Opinion Letter, Sept. 13, 1989.

<sup>703</sup> *See, e.g.*, Shellfish Culture, Inc., Miss. Sec. of State Opinion Letter, June 3, 1993 (convertible debenture offering to existing shareholders); Sunkist Country Club, Miss. Sec. of State Opinion Letter, June 26, 1991 (recapitalization transaction); Sun Equities Corp., Miss. Sec. of State Opinion Letter, Oct. 5, 1988 (distribution of rights to purchase shares of common stock without consideration, charge or assessment); VMS Strategic Land Fund II, Miss. Sec. of State Opinion Letter, Aug. 29, 1988 (share issuance to existing shareholders); Fast Foods Invs., Inc., Miss. Sec. of State Opinion Letter, Jan. 21, 1988 (securities issuance pursuant to bankruptcy reorganization plan); City Resources (Canada) Ltd., Miss. Sec. of State Opinion Letter, Dec. 14, 1987 (issuance of stock warrants); Princor Mutual Funds, Inc., Miss. Sec. of State Opinion Letter, Aug. 14, 1987 (mutual fund stock split); Paradyn Corp., Miss. Sec. of State Opinion Letter, May 13, 1987 (distribution of shares in accordance with court-appointed settlement to plaintiff class made up of existing shareholders).

There is no direct federal equivalent to the § 402(b)(11)/75-71-203(11) existing security holder exemption. Many of the offerings covered by such state exemption, however, may be exempt for Securities Act purposes under the § 3(a)(9) exemption for voluntary exchanges. Section 3(a)(9) exempts from registration under the Securities Act "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." 15 U.S.C. § 77c(a)(9) (1988). For a general discussion of the § 3(a)(9) exemption, see 3 LOSS & SELIGMAN, *supra* note 381, at 1228-41. "In any event

Like the institutional exemption in section 75-71-203(8), the existing security holders exemption in section 75-71-203(11) has no condition relating to information delivery or investment intent, no prohibition on general solicitation or advertising, and no numerical limitations on offerees, purchasers or aggregate offering price.

*b. Employee Benefit Plan Transactions:  
Section 75-71-201(11)*

Section 75-71-201(11) exempts from registration “[a]ny investment contract issued in connection with an employees’ stock purchase, savings, pension, profit-sharing or similar benefit plan.”<sup>704</sup> The exemption is based on section 402(a)(11) of the Uniform Act.<sup>705</sup> The Official Comment to section 402(a)(11) notes that the exemption is “designed to solve the problem which arises in those states whose administrators take the position, also taken by the SEC, that employees’ benefit plans of various kinds involve an offer of a security in the nature of an ‘investment contract.’”<sup>706</sup>

---

the exemption is quite narrow: (a) The issuer of both securities must be the same. (b) Under the administrative construction, no part of the offering may be made to persons other than existing security holders, or even to existing security holders otherwise than by way of exchange. (c) There may be no paid solicitation.” *Id.* at 1229-30.

<sup>704</sup> MISS. CODE ANN. § 75-71-201(11) (1991).

<sup>705</sup> 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1557-62. Section 401(a)(11) is conditioned on filing a notice with the state securities administrator before inception of the plan. There is no such notice requirement under the Mississippi version of the exemption.

<sup>706</sup> 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1561. For a discussion of the definition of “security” under the Securities Act, the Uniform Act and the Mississippi Securities Act and the “investment contract” component of such definition, see *Financing a Small Business (Part I)*, *supra* note 416, at 132-33 n.2. In *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979), the U.S. Supreme Court held that an employee’s interest in an involuntary, noncontributory pension plan did not fall within the “investment contract” component of the definition. The SEC takes the position that an employee’s participation in a benefit plan that is both voluntary and contributory does constitute an investment contract, and therefore a security. Securities Act Release No. 6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051, at 2073-11 (Feb. 1, 1980). But, the SEC has taken the administrative position that registration of such participation is only required where the plan “invests in securities of the employer an amount greater than that paid into the plan by the employer.” *Id.* at 2073-6; see also Securities Act Release No. 6281, 1 Fed. Sec. L. Rep. (CCH) ¶ 1052 (Jan. 15, 1981); 2 LOSS & SELIGMAN, *supra* note 381, at 1102-06; Simon M. Lorne & R. Gregory Morgan, *Securities Law Considerations*



The use of the term "investment contract" and the discussion in the Official Comment make it relatively clear that the exemption in section 402(a)(11) of the Uniform Act focuses on participations in a plan and not on the direct or indirect offer and sale of employer securities via the plan. The offer and sale of employer securities via an employee benefit plan is a separate problem under federal law.<sup>707</sup> Notwithstanding the identical language in the Mississippi exemption, the Secretary of State has confirmed availability of the exemption both for employer securities offered and sold via an employee benefit plan<sup>708</sup> as well as participations in a plan under circumstances in which they constitute an "investment contract."<sup>709</sup> This liberal interpretation of the section 71-71-201(11) exemption has been confirmed with respect to a broad variety of plans.<sup>710</sup>

---

*Affecting Employee Benefit Plans* A1, A-10 to -23 (BNA Corporate Practice Series 1990).

<sup>707</sup> See Securities Act Release No. 6188, *supra* note 614, at 2073-3 n.6. (stating that "[w]hether a separate security in the form of a plan interest exists depends on the facts and circumstances of the particular plan"); Securities Act Release No. 6867, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,605, at 80,850 n.135 (June 6, 1990); Lorne & Morgan, *supra* note 654, at A-9 to A-B.

<sup>708</sup> See, e.g., Regan Holding Corp., Miss. Sec. of State Opinion Letter, Dec. 4, 1991; Herff Jones, Inc., Miss. Sec. of State Opinion Letter, July 15, 1991; The Loewen Group, Inc., Miss. Sec. of State Opinion Letter, Feb. 13, 1990.

<sup>709</sup> See, e.g., MCI Communications Corp., Miss. Sec. of State Opinion Letter, June 10, 1988 (401(k) plan).

<sup>710</sup> See, e.g., International Family Entertainment, Inc., Miss. Sec. of State Opinion Letter, Mar. 26, 1990 (restricted stock plan); The Loewen Group, Inc., Miss. Sec. of State Opinion Letter, Feb. 13, 1990 (stock purchase plan and incentive stock option plan); McLane Co., Miss. Sec. of State Opinion Letter, Feb. 13, 1990 (executive equity participation plan); PCL Industries Ltd., Miss. Sec. of State Opinion Letter, Aug. 15, 1989 (stock purchase plan); MCI Communications Corp., Miss. Sec. of State Opinion Letter, June 10, 1988 (401(k) plan); Ecogen, Inc., Miss. Sec. of State Opinion Letter, Feb. 3, 1988 (stock option plan); Noble Drilling Corp. Thrift Plan, Miss. Sec. of State Opinion Letter, Jan. 14, 1988 (thrift plan); Planters Bank and Trust Co., Miss. Sec. of State Opinion Letter, Jan. 13, 1988 (profit sharing plan); Thomas Cardonna, Miss. Sec. of State Opinion Letter, Nov. 24, 1987 (incentive and qualified stock option plans, non-qualified stock option plan, annual incentive bonus plan, stock purchase plan, 401(k) plan and payroll stock ownership trust); Lynne Richardson, Miss. Sec. of State Opinion Letter, July 1, 1987 (profit sharing plan); Wilson Foods Corp., Miss. Sec. of State Opinion Letter, Apr. 23, 1987 (stock purchase plan); Anheuser-Busch, Miss. Sec. of State Opinion Letter, Feb. 5, 1986 (stock purchase plan); Meridian Express Co., Miss. Sec. of State Opinion Letter, Nov. 18, 1985 (stock purchase plan); W.A. Kruger Co., Miss. Sec. of State Opinion Letter, Aug. 22, 1985 (stock option plan and tax-deferred

However, given the language of the exemption, prudent issuers will probably continue to seek confirmation from the Secretary of State of the availability of the exemption for employer securities being offered or sold pursuant to employee plans in advance of implementing new plans. As interpreted by the Secretary of State, section 75-71-201(11) provides, in essence, an exemptive equivalent to SEC Rule 701, at least for securities offered and sold pursuant to compensatory *plans* — as opposed to compensatory *contracts*.<sup>711</sup>

Unlike the other Mississippi exemptions, section 75-71-201(11) of the Mississippi Code exempts the securities themselves, not the transaction in which they are offered or sold, from registration. As a result, there are no transaction-type restrictions or conditions (*i.e.*, no condition relating to information delivery, no prohibition on general solicitation or advertising, no resale restrictions and no numerical limitations on offerees, purchasers or aggregate offering price). However, section 75-71-201(11), like the other Mississippi exemptions, does not provide an exemption from the antifraud provisions of the Mississippi Securities Act.<sup>712</sup>

### 6. *Relationship Among the Exemptions*

One of the difficulties in coordinating federal and state securities exemptions is that the integration and aggregation rules that are relatively well developed on the federal level are

---

savings plan); CPI Int'l, Inc., Miss. Sec. of State Opinion Letter, Apr. 11, 1985 (savings/retirement plan); McRae's Inc., Miss. Sec. of State Opinion Letter, Apr. 2, 1985 (stock purchase plan); Eastern Air Lines, Inc., Miss. Sec. of State Opinion Letter, Feb. 21, 1985 (wage investment program); Aetna Life Ins. Co., Miss. Sec. of State Opinion Letter, Feb. 21, 1985 (incentive savings plan for agents); Gulf Oil Corp., Miss. Sec. of State Opinion Letter, Feb. 19, 1985 (stock bonus plan requiring compliance with ERISA).

<sup>711</sup> For a discussion of the meaning of the term "plan" under federal securities law, see *supra* notes 465-470 and accompanying text. In other respects, § 75-71-201(11) is potentially broader than SEC Rule 701 since it is not limited to nonpublic issuers and is not subject to the same conditions as Rule 701. See *supra* notes 441-516 and accompanying text. For two recent examples of § 75-71-201(11) providing a state analog to SEC Rule 701, see Regan Holding Corp., Miss. Sec. of State Opinion Letter, Dec. 4, 1991; Herff Jones, Inc., Miss. Sec. of State Opinion Letter, July 15, 1991.

<sup>712</sup> See *supra* notes 605-06 and accompanying text.

generally vague and ambiguous on the state level.<sup>713</sup> As a result, there are perplexing questions regarding how the various exemptions available for start-up and small business financing under the Mississippi Securities Act relate to each other.

For example, a Mississippi issuer may want to sell stock to thirteen investors, three of whom are institutions within the meaning of the section 75-71-203(8) exemption and ten of whom are not. Would the issuer be able to rely on the section 75-71-203(8) exemption for the three institutions and the section 75-71-203(9) limited offering exemption for the ten non-institutional investors, even though neither of those two exemptions alone would be sufficient to cover the whole offering?

Taking a strict approach to integration, one might reason that both section 75-71-203(8) and section 75-71-203(9) of the Mississippi Code are *transactional* exemptions. They are available for an entire "offering," not for selected offers and sales constituting parts of the entire "offering." Consequently, if the offers and sales to the thirteen investors are one big "offering," neither exemption is available to cover it. Whether those offers and sales do constitute one big "offering" would depend on application of some criteria such as the SEC's five factor test.<sup>714</sup>

The Uniform Act clearly counters this approach by direct reference in the limited offering exemption of section 402(b)(9) to the institutional exemption in section 402(b)(8). The 402(b)(9) exemption is available for "any transaction pursuant to an offer directed by the offeror to not more than ten persons (other than those designated in paragraph (8)) in this state during any period of twelve consecutive months)."<sup>715</sup> Each condition under section 402(b)(9) contains an additional, explicit

---

<sup>713</sup> For a discussion of the integration concept as it applies to Regulation D exemptions, see *Financing a Small Business (Part I)*, *supra* note 416, at 195-204. For a discussion of the aggregation concept as it applies to the Rule 504 and 505 exemptions under Regulation D, see *Financing a Small Business (Part I)*, *supra* note 416, at 154-56.

<sup>714</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 195-97.

<sup>715</sup> 1 Blue Sky L. Rep. (CCH) ¶ 5542, at 1559.



carve-out for the institutions covered by section 402(b)(8).<sup>716</sup> The clear meaning of the cross-reference is that the two exemptions are not intended, through the integration doctrine or otherwise, to limit each other's availability and that the two exemptions may be applied in tandem to cover one "offering" that neither would otherwise cover on its own.

Section 75-71-203(9) of the Mississippi Securities Act does not contain the same cross-reference to the institutional exemption in section 75-71-203(8) as in the Uniform Act. Whatever the reason for this exclusion, the relationship between the institutional exemption and the limited offering exemption in section 75-71-203(9) should be the same as under the Uniform Act. The institutional exemption is grounded in the *quality*, not the *quantity*, of investors. Given the restrictive qualifications necessary for coverage under the institutional exemption, it seems clear that the exemption should be treated as being independent from any limited offering exemption and capable of being used in tandem where institutions are purchasing along with non-institutions in what could be deemed to be one big "offering."<sup>717</sup>

---

<sup>716</sup> *Id.*

<sup>717</sup> Similar integration issues exist with respect to the existing security holder exemption in § 75-71-203(11). In the example in the text, if the issuer, in addition to selling shares to 13 new investors, wanted to do a simultaneous exchange offer of new notes with an existing class of note-holders in what clearly constitutes a single plan of financing, would the issuer be able to rely on the § 75-71-203(8) exemption for the 3 institutions, the § 75-71-203(9) exemption for the 10 non-institutions and the § 75-71-203(11) exemption for the exchange offer? Even under traditional SEC integration doctrine, the exchange offer may be deemed a separate "offering" (since it involves different securities and different consideration). But even if one big "offering" were involved, the better answer would appear to be that the issuer may rely on the 3 exemptions in tandem based on the diverse grounding of the exemptions. However, it should be noted that the § 75-71-203(11) exemption poses an additional integration problem since it is premised on an "offer to existing security holders of the issuer." See *supra* note 697 and accompanying text. If the issuer were making an offer of common stock to existing shareholders and to the 13 outside investors, an offer to existing security holders as such may not exist and the § 75-71-203(11) exemption would not be available.

The § 75-71-201(11) exemption for investment contracts offered pursuant to employee benefit plans should not pose integration problems. First, the § 75-71-201(11) exemption is for exempt *securities* not exempt *transactions*. Consequently, the

The integration issues become more difficult when attempting to combine more than one limited offering exemption. For example, if an issuer wants to sell to forty-five non-institutional and non-accredited investors in an offering, may it rely on a combination of the section 75-71-203(9) exemption along with the Rule 703 or Rule 705 exemption, even though none of those exemptions alone would be sufficient? The answer is quite clearly *no* insofar as the Rule 703 exemption is concerned. Both the standard and Mississippi versions of ULOE provide that "[t]ransactions which are exempt under this rule may not be combined with offers and sales exempt under any other rule or section of the act."<sup>718</sup> This appears to be an adaptation of the SEC's integration doctrine.

Rule 705 does not contain the same explicit prohibition on combining exemptions. Does that mean that Rule 705 may be used in tandem with the limited offering exemption in section 75-71-203(9)? Given the similar grounding of both exemptions, the better answer is probably *no*. What about the institutional exemption in section 75-71-203(8)? May an issuer rely on it in tandem with Rule 705? For the reasons already discussed, the better answer is clearly *yes*. However, prudent issuers may be hesitant to rely on this answer without interpretive advice from the Secretary of State.

---

integration doctrine should not apply at all. In other words, securities covered by the § 75-71-201(11) exemption may be offered and sold without abridging in any way the availability of transactional exemptions like § 75-71-203(9). Even if the traditional integration doctrine applied, however, employee benefit plan transactions would almost never be integrated with financing or other non-compensatory transactions. See *Financing a Small Business (Part I)*, *supra* note 416, at 203. Nonintegration of transactions pursuant to employee benefit plan transactions is also consistent with the approach taken by the SEC in Rule 701 under the Securities Act. See *supra* notes 479-82 and accompanying text.

<sup>718</sup> NASAA Rep. (CCH) ¶ 6201, at 6,104; see also 2 Blue Sky L. Rep. (CCH) ¶ 34,522, at 29,422-24. This provision goes on to clarify that "nothing in this limitation shall act as an election [and] . . . [s]hould for any reason, the offer and sale fail to comply with all of the conditions for the exemption, the issuer may claim the availability of any other applicable exemption." 2 Blue Sky L. Rep. (CCH) ¶ 34,522, at 29,243.

### C. SCOR: Form U-7

One significant recent development in coordination of the federal and state exemptive structures does not relate to a blue sky exemption at all. Instead, it relates to the development of a simplified and relatively inexpensive new state registration procedure and form for use in small public offerings exempt for federal purposes under Rule 504 of Regulation D.

#### 1. Background

In order to address the need for such a procedure, a special study group of the Business Law Section of the American Bar Association joined with NASAA to develop a Uniform Limited Offering Registration (ULOR) procedure.<sup>719</sup> The ULOR project resulted in development of a new registration statement form known as the Small Corporate Offering Registration form (SCOR or Form U-7).<sup>720</sup> In April 1989, NASAA approved SCOR in final form for use in state-registered public offerings which are exempt from Securities Act registration under Rule 504 of Regulation D.<sup>721</sup> Since then, more than thirty states have adopted the form and a number of other states are either considering official adoption or have informally allowed use of the form.<sup>722</sup>

The form consists of a simplified, question-and-answer disclosure document to which the issuer attaches its financial statements. After review for effectiveness with state securities regulators, the issuer uses the completed Form U-7, with attached financials, as the prospectus. Only corporate issuers

---

<sup>719</sup> See Jean E. Harris, et al., *Financing the "American Dream": A Beginning*, 44 BUS. LAW. 625 (1989); Jean E. Harris, et al., *Financing the "American Dream" — Small Business and the ULOR Project*, 43 BUS. LAW. 757 (1988).

<sup>720</sup> See Jean E. Harris, et al., *Financing the "American Dream": ULOR SCOR[ES]*, 45 BUS. LAW. 1343 (1990).

<sup>721</sup> NASAA Rep. (CCH) ¶ 5057, at 5,197-300.

<sup>722</sup> *Id.* ¶ 267, at 299-9 to 300 (State Adoptions of Small Corporate Offering Registration Program and Form U-7); see also G. Michael Stakias & Jean E. Harris, *Simplifying Registration of Small Corporate Offerings: Form U-7 "SCORs"*, INSIGHTS, July 1992, at 13. See generally Mark A Sargent, *Blue Sky Law: The SCOR Solution*, 18 SEC. REG. L.J. 93 (1990).



may use the current SCOR form,<sup>723</sup> although a partnership version is currently being developed.

In addition to the theoretical simplicity afforded by the Q & A format, SCOR requires only reviewed, rather than audited, financial statements if: (1) the offering does not exceed \$500,000; (2) the issuer has not previously sold securities in an offering involving general solicitation of investors; (3) the corporation has not previously been required by law to provide audited financial statements in connection with the sale of its securities; and (4) the aggregate amount of all previous sales of securities by the issuer (excluding bank and other commercial debt financings) does not exceed \$1,000,000.<sup>724</sup>

There are a number of significant restrictions on the use of SCOR. First, the form is available for registration of no more than \$1,000,000 in aggregate offering price of securities, less the aggregate offering price of all Rule 504 offerings by the issuer during the preceding twelve months.<sup>725</sup> Second, Form U-7 is available only for offerings by issuers, not for registration of secondary offerings.<sup>726</sup> Third, the form may not be used for stock offerings at a price less than \$5 per share.<sup>727</sup> The purpose of this restriction is to discourage offerings that would result in overly volatile post-offering trading. Fourth, SCOR contains "bad boy" disqualifiers equivalent to those under ULOE.<sup>728</sup> Finally, "blind pool" offerings, in which the specific business or properties to be acquired cannot be described in the disclosure, are also not eligible for Form U-7.<sup>729</sup>

---

<sup>723</sup> See NASAA Rep. (CCH) ¶ 5057, at 5,197-206. (Instructions for Use of Form U-7—Item II(A)).

<sup>724</sup> *Id.* (Instructions for Use of Form U-7—Item IV(K)).

<sup>725</sup> *Id.* (Instructions for Use of Form U-7—Item II(F)).

<sup>726</sup> *Id.* (Instructions for Use of Form U-7—Item II(B)).

<sup>727</sup> *Id.* (Instructions for Use of Form U-7—Item II(C)).

<sup>728</sup> *Id.* (Instructions for Use of Form U-7—Item II(E)).

<sup>729</sup> *Id.* (Instructions for Use of Form U-7—Item II(A)).

2. *SCOR and the Small Business Initiatives — Use with Revised Regulation A and the Transitional S-B System*

In 1992, as part of the first round of its so-called Small Business Initiatives, the SEC substantially expanded and revised the exemption from registration for small public offerings contained in Regulation A under the Securities Act.<sup>730</sup> One of the revisions to Regulation A permits corporate issuers to use a question-and-answer format as an alternative to more traditional formats in the required offering circular. This change is intended to make the SCOR form available for state registration of public offerings carried out, for federal purposes, under Regulation A as well as Rule 504.

In 1993, as part of the second round of its Small Business Initiatives, the SEC adopted a transitional level in its new S-B disclosure system that permits certain "small business issuers" to register securities under the Securities Act and report under the Exchange Act using either a traditional Regulation A format or the question-and-answer format developed for SCOR.<sup>731</sup>

As a result of the Small Business Initiatives, the SCOR format is now a disclosure alternative for small business issuers across the full range of state and federal securities law. It remains to be seen whether the enthusiasm for the SCOR concept shown by state and federal regulators will be matched by that of issuers and their counsel.<sup>732</sup>

---

<sup>730</sup> See Securities Act Release No. 6949, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,439, at 62,165 (July 30, 1992); see also *Financing a Small Business (Part I)*, *supra* note 416, at 143, 182-87.

<sup>731</sup> See *Financing a Small Business (Part I)*, *supra* note 416, at 184-87.

<sup>732</sup> Initial reactions are mixed at best. See, e.g., Harold S. Bloomenthal, *Transitional Integrated Disclosure System for Small Business Issues (Part II)*, 15 Sec. & Fed. Corp. L. Rep. 52, 55 (1993) ("The question-and-answer format of Model A is of dubious advantage in the public offering context and no advantage in the context of Exchange Act reports. Model A requires more extensive disclosure than Model B in several respects."). Practitioners which the author has talked to about SCOR uniformly feel it is well-intentioned, but unwieldy and ultimately unworkable.

### 3. SCOR in Mississippi

Mississippi is one of the growing number of states that accepts SCOR filings, although there have been very few such filings made in the state to date.<sup>733</sup> In addition to adopting SCOR as a registration form, the Mississippi Secretary of State has promoted its use as a format for disclosure in exempt offerings. In 1991, the Secretary of State amended the Rule 703 ULOE exemption and the Rule 705 domestic issuer limited offering exemption to note that the use of SCOR "may be acceptable for compliance" under the provisions which require filing of disclosure documents as a condition to the exemption.

The purpose of this reference is to endorse SCOR as a nonexclusive model for disclosure in Rule 703 offerings — presumably only insofar as such offerings relate to accredited investors, since Rule 505 or 506 offerings to non-accredited investors must meet the specific disclosure requirements prescribed in Regulation D — and Rule 705 offerings which are not conditioned on provision of any prescribed disclosures. The Mississippi Secretary of State's Securities Division regularly distributes copies of SCOR to issuers and others making inquiry regarding appropriate disclosure under the state's blue sky exemptions.<sup>734</sup> The reference should not be viewed as requiring any particular disclosure as a condition to availability of the exemptions.

### D. Suggested Revisions

In recent years, the Mississippi Secretary of State has done an excellent job of bringing the state's securities exemptions applicable to start-up and small business financing into the

---

<sup>733</sup> Telephone Interview with Michael Henry, Securities Division, Mississippi Secretary of State (Feb. 23, 1993).

<sup>734</sup> Telephone Interview with Michael Henry, Securities Division, Mississippi Secretary of State (Mar. 17, 1993). See Jean E. Harris & Hugh H. Makens, *Uniform Form for Small Offerings*, 23 Rev. Sec. & Commodities Reg. 219, 221 (Dec. 5, 1990) (concluding that "[p]erhaps the greatest benefit of the form lies not in its use as a registration document, but rather as a format for small business issuers engaged in private placements").



mainstream of blue sky regulation and keeping them there. The Mississippi exemptions are more burdensome than those of some other states, less burdensome than those of others. Ultimately, issuers and investors alike may be best served by wholesale revision of blue sky regulations throughout the United States, a complete overhaul based on a reconsideration of the balance between the competing needs for investor protection and ease of capital formation and a rethinking of the appropriate roles for federal and state authorities. I do not, however, suggest that the State of Mississippi do anything to take itself out of the mainstream of blue sky regulation, and so wholesale reform will have to wait. In the meantime, there are a number of things that could be done in Mississippi to facilitate start-up and small business financing consistent with protection of investors and better coordination with the federal exemptive structure.

1. *Inclusion of Accredited Investors as  
"Other Institutional Investors"*

As discussed above,<sup>735</sup> the Secretary of State should give serious thought to joining Illinois, Iowa, Minnesota and Oregon by including "accredited investors" as defined in Regulation D within the institutional exemption. An unrestricted, self-effectuating exemption covering these familiar categories of investors would substantially decrease the securities law burden on start-up and small business financing and go a long way toward embodying the reasonable expectations of entrepreneurs regarding whom they should be able to sell securities to without notices, filings, fees or other government intervention. Adoption of such an exemption would greatly reduce the need for the other revisions suggested.

---

<sup>735</sup> See *supra* notes 623-29 and accompanying text.

2. *Elimination of Filings as Condition to the Rule 703 and Rule 705 Exemptions*

There is simply no excuse for not amending the burdensome and nonuniform notice provisions in Rules 703 and 705 to conform to the approach taken in Rule 507 of Regulation D: filings and fee payments should be a requirement, but not a condition to the availability of the exemption. Eliminating the filing condition would remove a trap for the unwary with no sacrifice to protection of investors.<sup>736</sup> In addition, applying a substantial compliance provision to the notice filing requirement does not adequately take care of the problem.<sup>737</sup>

3. *Elimination of Restrictions in Section 75-71-203(9) and Rule 705 on Offers by Persons Other than Officers, General Partners and Registered Broker-Dealers*

At a minimum, non-officer directors and promoters of the issuer should be permissible offerors. As long as the prohibition on payment of commissions remains in place, it is unlikely that this broadening of permissible offerors would have any detrimental effect on investor protection.

---

<sup>736</sup> Accord Sargent & Makens, *supra* note 663, at 1328-29. One argument in favor of retaining the notice filing as an absolute condition to availability of the exemption is that it facilitates enforcement efforts against perpetrators of fraudulent securities scams. When unscrupulous sellers fail to file the notice, they lose their exemptions and violate the state registration requirement. State securities administrators may then pursue injunction or other remedies based on failure to register rather than fraud charges. To prove a failure to register, state administrators need only prove that an offering was made and that no registration occurred. The seller then has the burden of proving availability of an exemption. Failure to file a notice constituting an absolute condition eliminates any ambiguity about availability of an exemption. This relieves administrators from having to prove the much more difficult charge of securities fraud in order to shut down the scam.

In the end, I believe it is wholly inappropriate to include technical conditions in securities exemptions which have no real purpose other than to ensure that a large percentage of users, both scrupulous and unscrupulous, lose the exemption and become technical lawbreakers. Whatever economies such an approach affords enforcement efforts are offset by the cynicism it breeds about the securities laws.

<sup>737</sup> See *supra* notes 682-83 and accompanying text.

4. *Adoption of ULOE Due Diligence Defense to  
"Bad Boy" Disqualification*

Commentators have suggested that ULOE should be amended to make the substantial compliance provision applicable to the "bad boy" disqualification provisions.<sup>738</sup> However, I do not suggest that Mississippi do so until NASAA has so amended standard ULOE. In the meantime, Mississippi should at least conform to standard ULOE by adopting the due diligence defense for the issuer.<sup>739</sup>

---

<sup>738</sup> See Sargent & Makens, *supra* note 663, at 1327.

<sup>739</sup> See *supra* notes 678-79 and accompanying text.





# COMPLEX/MASS TORT LITIGATION IN STATE COURTS IN MISSISSIPPI

*Guthrie T. Abbott\**  
*Pope S. Mallette\*\**

## I. INTRODUCTION

This article will address the present status of complex or mass tort litigation in state courts in Mississippi and suggest some areas of concern as well as some additions or amendments to procedural rules and statutes which might help the courts manage such controversies. The presence of mass tort litigation is apparent to anyone who regularly reads a newspaper. There is great public interest in the legal maneuvering involved in claims for damages based upon matters such as exposure to asbestos, dioxin or problems resulting from breast implants. The authors' interest in this topic was spurred by newspaper and magazine reports of the growing number of legal controversies which involve large numbers of parties with claims which are related in some manner. However, beginning the research for this article revealed a problem which needs to be, and apparently is being remedied. There was no source available to determine how many lawsuits or collections of pending suits in Mississippi state courts might be classified as complex or mass tort matters.

Fortunately, help is on the way. In the spring of 1993, the Mississippi State Legislature created the Administrative Office

---

\* Professor of Law and Butler, Snow, O'Mara, Stevens and Cannada Lecturer, University of Mississippi. B.A. & J.D., University of Mississippi, 1964 & 1967. Fellow in Law and the Humanities, Harvard University, 1975.

\*\* B.A. Vanderbilt University, 1985; Third Year Law Student, University of Mississippi.

of Courts (AOC).<sup>1</sup> Section 9-21-3 of the Mississippi Code requires the AOC "[t]o work with the clerks of all civil and criminal trial courts in the state to correct, obtain, compile, digest and publish information and statistics concerning the administration of justice in the state."<sup>2</sup> In addition, the state legislature has conferred upon the Administrative Director of Courts the authority to "determine the state of the dockets and evaluate the practices and procedures of the courts and make recommendations concerning the number of judges and other personnel required for the efficient administration of justice."<sup>3</sup>

The Honorable Martin T. Smith serves as Administrative Director of the newly created Supreme Court AOC, and Mr. Smith has been of great help in providing background information for this article. Martin Smith advises that the collection of data on state-wide case filings is underway through use of Form AOC/01 (Cover Sheet-Civil Case Filing Form) which, as of October 1, 1993, has been required with every civil action filed in Mississippi. The AOC/01 Form is filed in triplicate, and each Friday all trial court clerks are to send one copy to the AOC office, where the comprehensive data regarding type of claim, court, number of parties, and other vital case information is entered into a computer. Ultimately, a disposition copy for each case filing will be sent to the AOC. For the first time, those administering the court system in Mississippi will have the necessary information to gauge needs on a state-wide basis.

Unfortunately, for purposes of this article, such information has not yet been accumulated. Consequently, the authors have had to collect information independently in order to arrive at a best estimate of the amount of mass tort litigation in Mississippi state courts. First, by letter of September 15, 1993, a questionnaire was sent to all circuit, chancery, and county court judges in the state. One hundred and three of the following

---

<sup>1</sup> MISS. CODE ANN. § 9-21-1 (Supp. 1993). The stated purpose of the AOC is to assist state courts in the "efficient administration of nonjudicial business." *Id.*

<sup>2</sup> *Id.* § 9-21-3(2)(a) (Supp. 1993).

<sup>3</sup> *Id.* § 9-21-9(b) (Supp. 1993).



forms were sent to the judges with a request to respond by October, 1993:

QUESTIONNAIRE ON COMPLEX/MASS  
TORT LITIGATION IN MISSISSIPPI

\_\_\_\_\_ Court for County or Counties of \_\_\_\_\_.

JUDGE \_\_\_\_\_

1. Has your court handled any litigation which you feel could be classified as complex or mass tort litigation. **(If Yes, please give a brief description of the type of litigation including the approximate number of suits and parties involved and the counties involved. If No, please skip to question number 5.)**  
\_\_\_\_ YES                      \_\_\_\_ NO
2. If you have used case management techniques to aggregate claims or parties in such cases, please give a brief description of the procedures used below. Copies of sample orders used would be welcome.
3. Please describe below any methods you have used to limit, order, or avoid duplication and expense of discovery in such cases. **Copies of any orders used would be welcome.**
4. Please describe any transfers of venue ordered in such cases in order to achieve aggregation or consolidation.
5. Please share any opinion which you care to with regard to whether Mississippi should or should not have a Rule 23 permitting class action litigation.

Fifty-two trial court judges returned the questionnaire. Questionnaire responses referred in a general manner to both ongoing and completed litigation which trial judges felt were "complex" or "mass tort." The breakdown, by courts, was as follows:

**CIRCUIT JUDGES**

|                                                    |    |
|----------------------------------------------------|----|
| Reporting no complex or mass tort litigation ..... | 14 |
| Have handled complex or mass tort litigation ..... | 5  |

**CHANCERY JUDGES**

|                                                    |    |
|----------------------------------------------------|----|
| Reporting no complex or mass tort litigation ..... | 20 |
| Have handled complex or mass tort litigation ..... | 2  |

**COUNTY COURT JUDGES**

|                                                    |    |
|----------------------------------------------------|----|
| Reporting no complex or mass tort litigation ..... | 11 |
| Have handled complex or mass tort litigation ..... | 0  |

The results of the questionnaire require some thought and analysis. First, although the determination of what comprised "complex or mass tort litigation" was subjective for each respondent, the description of the responses reveals a great deal of consistency in definition. Second, since only 52 of 103 judges responded, the authors used newspaper reports and communications with persons known to be involved in mass tort matters in order to try to bridge the gap in data. Third, the low number of judges advising that they had actually handled any complex or mass tort matters belies the gravity of the problem, as some of the litigation involves thousands of plaintiffs suing numerous defendants. In addition, several judges who are known to be handling highly publicized mass tort matters were unable to respond to the survey. In spite of the aforementioned shortcomings in data collection, the authors are convinced that the Mississippi state court system has a major task at hand in dealing with current filings of a mass tort nature and that the foreseeable future will bring an increase in such litigation.

Leaders in the bar and judiciary share common concerns about the impact of massive litigation on our state court system. When the Judicial Advisory Study Committee of the Mississippi Bar met on September 24, 1993, the first item on

the agenda was a report on mass tort litigation in our state courts.<sup>4</sup>

Senior Circuit Judge Kathy King Jackson of the 19th Circuit Court District gave a detailed report of problems she has experienced in presiding over asbestos litigation in her district.<sup>5</sup> Judge Jackson's testimony before the Judicial Advisory Study Committee, coupled with her letter of September 10, 1993, to the chairman of the same committee, paint a vivid picture of concerns which need immediate attention.<sup>6</sup> The same hearing brought forth oral testimony and letters from lead attorneys for plaintiffs<sup>7</sup> and defendants<sup>8</sup> in the asbestos cases. Each seemed to express the same sentiment: "These cases are here to stay."<sup>9</sup>

Judge Jackson's letter of September 10, 1993<sup>10</sup> advised that the 19th Circuit Court District currently has 12,000 asbestos cases, 12,000 dioxin cases, and 3,000 hearing loss cases. Also pending in the 19th Circuit Court District are claims by approximately 1,000 plaintiffs alleging personal injury from "vibration" resulting from the use of tools at the Pascagoula shipyard.<sup>11</sup>

Examples of ongoing complex/mass tort litigation are not limited to southeast Mississippi, as illustrated by the following:

---

<sup>4</sup> MINUTES OF THE MISSISSIPPI BAR JUDICIAL ADVISORY STUDY COMMITTEE at 1 (Sept. 24, 1993) (on file with Administrative Office of Courts, Jackson, Mississippi) [hereinafter MINUTES].

<sup>5</sup> MINUTES, *supra* note 4, at 1-2.

<sup>6</sup> *Id.*; Letter from Honorable Kathy King Jackson, Circuit Court Judge, 19th Circuit Court District, to Honorable Grady Tollison, Chairman, Judicial Advisory Study Committee of the Mississippi Bar (Sept. 10, 1993) (on file with Administrative Office of Courts, Jackson, Mississippi) [hereinafter *Letter of Judge Kathy King*] (describing administrative complications of four and one-half month asbestos trial consisting of 12,000 claims).

<sup>7</sup> MINUTES, *supra* note 4, at 2-3. Honorable David O. McCormick and Honorable Richard F. Scurggs of Pascagoula, Mississippi commented on behalf of asbestos plaintiffs. *Id.*

<sup>8</sup> *Id.* at 3-4. Hon. Roy C. Williams of Pascagoula, Mississippi and Hon. W. G. Watkins of Jackson, Mississippi commented on behalf of asbestos defendants. *Id.*

<sup>9</sup> *Id.* at 2, 4.

<sup>10</sup> See *supra* note 6.

<sup>11</sup> *Patton v. Ingersoll-Rand Co.*, No. 89-5148 (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed April 28, 1989).



(1) On October 20, 1993, Hinds County Circuit Judge Robert Gibbs entered a thirty-one page case management order in silicone breast implant litigation involving hundreds of plaintiffs and numerous defendants.<sup>12</sup>

(2) The Circuit Court of Coahoma County, Mississippi, has pending a personal injury action by multiple plaintiffs against numerous chemical company defendants alleging injuries resulting from an explosion in the Clarksdale, Mississippi area in 1985.<sup>13</sup>

(3) The Circuit Court of Jefferson County, Mississippi, is managing claims by 666 plaintiffs arising out of a train derailment which occurred on September 7, 1986, in Collins, Mississippi.<sup>14</sup>

As noted above, these cases are here to stay.<sup>15</sup> Only the bounds of the imagination of able attorneys will constrict the growing number of mass tort cases. Several large ships carrying the potential for massive litigation may already be seen on the horizon. Preliminary skirmishes are underway with suits against the tobacco industry. While an army of potential plaintiffs watch from the sidelines, dire warnings abound. The following language is exemplary of the potential for massive litigation in many areas of our modern society:

To grasp the potential magnitude of electromagnetic field (EMF) litigation, consider that virtually every time you cause electricity to be sent through a wire, an electromagnetic field is created. That means that the electric clock on your nightstand emits EMF.

So does your microwave oven, your electric shaver, your computer and every other electrical device you either use or are exposed to every day. And that includes the high-voltage power-lines that crisscross the country.

---

<sup>12</sup> *Floyd v. Medical Eng'g Corp.*, No. 92-73-157 (Miss. Cir. Ct. Hinds Cty., 7th Jud. Dist., filed Oct. 20, 1993) (case management order); see also Beverly P. Kraft, *Plan Streamlines Pretrial Activity in Implant Suits*, CLARION LEDGER, Oct. 21, 1993, at B1.

<sup>13</sup> *Johnson v. Red Panther Chem. Co.*, No. 8193 (Miss. Cir. Ct. Coahoma Cty., 11th Jud. Dist., filed Nov. 25, 1991).

<sup>14</sup> *Hathorn v. Illinois Cent. Gulf R.R.*, No. 7818 (Miss. Cir. Ct. Jefferson Davis Cty., 15th Jud. Dist., filed Sept. 4, 1992).

<sup>15</sup> See *supra* note 9 and accompanying text.

You, like the rest of us, live, love, work and play in a sea of EMF. It is not at all clear whether you should be concerned about this. Perhaps not. But then again, exposure to EMF may increase your risk of contracting cancer, leukemia and other serious diseases. So far, the research is inconclusive.

But that hasn't stopped the legal machinery from gearing up for what soon may become a tortuous journey into the murky realms of mass tort litigation. In fact, EMF litigation already exhibits significant parallels to asbestos litigation at a similar stage in its development. But the omnipresence of EMF in our daily lives suggests that this new litigation has the potential to open up a legal abyss that would dwarf the one created by asbestos.<sup>16</sup>

The task at hand is to devise methods which will enable our state courts to cope with such massive litigation. The thesis of this article will not be to suggest that there is a single method or particular approach best suited to handle mass tort litigation. Rather, this article simply suggests that "complex" litigation is aptly named and must be dealt with in a refined and incident specific manner. Judges and attorneys need a wide array of procedural devices available to them in order to craft case management plans which can cope with unique features that arise in any parcel of litigation which can rightly be called "complex."

This article will briefly examine and trace the history of the creation of the Judicial Panel on Multidistrict Litigation. The authors will make reference to suggested innovations to intertwine state/federal litigation and to suggested procedures which might allow aggregation/consolidation in one state court system of cases pending in multiple states. However, the major focus is on how the Mississippi court system is currently equipped to deal with the expanding numbers of mass tort or complex litigation, such as those surrounding claims of asbestosis, dioxin exposure, hearing loss, etc.

---

<sup>16</sup> Roy W. Krieger, *On The Line*, A.B.A. J., Jan. 1994, at 40.

## II. SOME CURRENT APPROACHES TO CASE MANAGEMENT IN MISSISSIPPI

At least three of the ongoing mass tort matters in Mississippi state courts have brought forth comprehensive case management directives from trial judges. The brief descriptions of ongoing case management which follow illustrate how our state judges are coping with a growing problem.

### A. *Asbestos Litigation*

The asbestos litigation in Jackson County, Mississippi has progressed further than any of the other ongoing mass tort matters. Senior Circuit Judge Kathy King Jackson has entered detailed orders and amended orders regarding case administration, scheduling, plaintiff selection, discovery, and trial. A brief description of the approaches taken by Judge Jackson in the asbestos litigation will illustrate several points. First, it will show that case management in these matters is, of necessity, case specific, although there is an obvious list of topics which must be dealt with in virtually all cases. Second, it must be noted that there is strong disagreement among litigants as to the authority of a trial judge, at least under existing procedures, to order certain approaches such as a common issues trial with a representative plaintiff wherein the verdict will be deemed to "apply to all cases pending."<sup>17</sup>

As Judge Jackson noted in her January 31, 1992 "Order Governing Case Administration," the presence of more than 6,000 plaintiffs before the court with various asbestos related claims requires an order to manage the administrative matters.<sup>18</sup> That order also dealt with matters as varied as the mechanics of service and style of pleadings and other papers to

---

<sup>17</sup> See, e.g., *Asbestos Personal Injury Cases* Abrams Lead Nos. 88-5422(2), etc. (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed April 8, 1993) [hereinafter *Asbestos Personal Injury Cases*] (order concerning common issues); see also *infra* part IV.B. (parallel controversy surrounding use of class actions in mass tort cases).

<sup>18</sup> *Asbestos Personal Injury Cases*, *supra* note 17 (order governing case administration).



the selection of liaison counsel for plaintiffs and defendants as well as the manner and timing of some aspects of the discovery process.<sup>19</sup> Further types of case management orders entered by Judge Jackson in the asbestos cases ordered designation of plaintiffs to be included in a "trial group," control of exchanges regarding documents and witnesses for trial, and the setting of schedules for all aspects of trial preparation.<sup>20</sup>

By Order of April 8, 1993, Judge Jackson granted plaintiffs' motion for a consolidated trial of common issues of law and fact.<sup>21</sup> The Jackson County asbestos trial was unique to the Mississippi court system. Nine designated plaintiffs actually participated in the trial, but the court's order provided "that any defendant or plaintiff's verdict as to any defendant's products or conduct placed at issue in this trial shall apply to all cases pending in the above styled and numbered causes."<sup>22</sup>

The trial was conducted at the fairgrounds in Jackson County, Mississippi, and lasted four and one-half months before the jury returned its verdicts on August 6, 1993. In a letter of September 10, 1993,<sup>23</sup> to the Mississippi Bar Judicial Advisory Study Committee, Judge Jackson detailed some of the logistical problems in overseeing the case. The sheer volume of people involved caused problems. Pretrial motions would bring 50 to 75 lawyers representing thousands of plaintiffs and as many as 100 defendants and caused all other matters pending in the circuit court to come to a halt.<sup>24</sup> Judge Jackson counted 53 lawyers in the makeshift courtroom at the fairgrounds on the day opening statements began.<sup>25</sup> The county had no resources to provide proper facilities for such a proceeding. The acoustics were so poor in the makeshift courtroom that the attorneys

---

<sup>19</sup> *Id.*

<sup>20</sup> *See, e.g., Asbestos Personal Injury Cases, supra* note 17 (order governing scheduling, plaintiff selection and trial).

<sup>21</sup> *Asbestos Personal Injury Cases, supra* note 17 (order concerning common issues).

<sup>22</sup> *Id.* Although there were only nine designated plaintiffs, the order applied to the claims of thousands of individual plaintiffs involved in the litigation. *Letter of Judge Kathy King, supra* note 6, at 1-2.

<sup>23</sup> *Letter of Judge Kathy King, supra* note 6.

<sup>24</sup> *Id.* at 1-2.

<sup>25</sup> *Id.* at 2.

provided carpeting.<sup>26</sup> Judge Jackson has called upon the state for the financial support needed to provide trial judges with adequate numbers of judges, facilities, clerks, clerical help and research assistance to handle such mass litigation.<sup>27</sup>

### B. Other Case Management Orders

Comprehensive case management orders are becoming the norm in cases with numerous parties. On October 20, 1993, Hinds County Circuit Judge Robert L. Gibbs signed a thirty-one page case management order in the highly publicized silicone breast implant litigation.<sup>28</sup> Judge Gibbs' order illustrates many of the current problems of such dispersed mass tort litigation as the order touches on objections to venue and coordination of the Mississippi breast implant litigation with ongoing multi-district litigation in Alabama and Ohio.<sup>29</sup>

Circuit Court Judge James W. Backstrom of the 19th Circuit Court District has been assigned more than 200 civil actions, including more than 8,800 individual plaintiffs alleging injury from the discharge of dioxin in the waters of the state. By order of August 18, 1993, Judge Backstrom called for the submission of proposed case management orders relating to those actions.<sup>30</sup> However, after the orders were submitted, Judge Backstrom by order of November 9, 1993, stayed certain aspects of the proceedings in all of those cases pending decisions by the Mississippi Supreme Court in two dioxin cases tried in the Nineteenth Circuit Court District and appealed to the Mississippi Supreme Court.<sup>31</sup> The following quote from Judge Backstrom's order highlights the myriad issues involved

---

<sup>26</sup> MINUTES, *supra* note 4, at 1.

<sup>27</sup> *Id.* at 2.

<sup>28</sup> See *supra* note 12 and accompanying text.

<sup>29</sup> For a discussion of venue and multi-state issues of mass tort cases see *infra* parts IV.A. (discussing venue) and III.B.4., C. (describing manuals of complex, multi-district litigation, and state coordination).

<sup>30</sup> *In re: Mississippi Dioxin Litigation* (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed Apr. 8, 1993) (order concerning common issues).

<sup>31</sup> *Id.* (order staying proceedings).

in such mass litigation and the fact that much jurisprudential ground-breaking is underway:

IT IS FURTHER ORDERED that discovery and proceedings relating to discovery may proceed in these cases regarding those issues that are not before the Mississippi Supreme Court in the two cases previously mentioned, and if the attorneys for the parties find the need for scheduling orders in this regard, or changing scheduling orders, then the matter may be presented to this Court for determination after counsel have been unable to reach an agreement on the matter upon conferring thereon. Any Dioxin cases presently set for trial are continued until further order of the Court. The Court is anxiously awaiting a decision of the Mississippi Supreme Court on the novel issues that are presented in this Dioxin litigation so that these numerous cases may move forward to a conclusion. Delays in litigation should not be granted in normal situations, but it would not be wise and prudent to proceed down uncharted waters when the right course might be on the horizon.<sup>32</sup>

The asbestos, breast implant, and dioxin cases described above are just a portion of the current crop of mass tort matters which are having a dramatic effect on our state court system.

The following sections of this article will examine suggestions made and actions taken by scholars and jurists throughout the nation to help navigate the uncharted waters mentioned above by Judge Backstrom.

### III. HISTORICAL BACKGROUND

#### A. *Causes*

Although the authors will discuss various judicial and legislative *responses* to problems of growing complex litigation, examining underlying *causes* in this area is a difficult but worthwhile task. A panel of federal judges appointed to study the problem wisely pointed out only the obvious origins, as it stated in its handbook's preface: "Modern American business is big and complex, consequently many of its controversies are

---

<sup>32</sup> *Id.*



big and complex.”<sup>33</sup> Although the statement’s importance is masked by its plainness, additional analysis shows that there are at least a few specific, identifiable causes for the growth in complex litigation over the last half century.

Richard Marcus and Edward Sherman point to the growth of substantive and procedural law (including the adoption of the Federal Rules of Civil Procedure in 1938) and their use as tools for social change as root causes of the expansion in modern litigation.<sup>34</sup> They point to comparisons of securities, civil rights and antitrust cases on federal court dockets in 1938, with similar statistics for today’s dockets, as proof positive that modern law itself has played a large role in the growth of litigation.<sup>35</sup> The authors consider the difficulty of defining “complex litigation” as evidence that the category is little more than a symptom of the “growing public inclination to litigate virtually any issue.”<sup>36</sup> However, they also acknowledge that the complexity of certain cases changes the litigatory problem, and to some extent, the roles of lawyers and judges faced with tackling the complex and involved cases.<sup>37</sup>

The American Law Institute (ALI), without contradicting reasons given above, takes a more detailed look at the particular legal areas that have spawned complicated lawsuits.<sup>38</sup> They cite antitrust litigation, mass torts, asbestos litigation, single mass catastrophes, and growing environmental concerns and resultant litigation, along with the increased intricacies of daily life generally in latter twentieth century America, as causes for the complex litigation boom.<sup>39</sup> As it concludes in its *Complex Litigation Project* that the causes of complex litigation

---

<sup>33</sup> *Handbook of Recommended Procedures for the Trial of Protracted Cases*, 25 F.R.D. 351, 359 (1960).

<sup>34</sup> RICHARD L. MARCUS & EDWARD F. SHERMAN, *COMPLEX LITIGATION: CASES AND MATERIALS ON ADVANCED CIVIL PROCEDURE* 1 (1st ed. 1985).

<sup>35</sup> *Id.* at 1-2.

<sup>36</sup> *Id.* at 2.

<sup>37</sup> *Id.*

<sup>38</sup> COMPLEX LITIGATION PROJECT, ch. 2, reporter’s note to cmt. *a* at 11-17 (American Law Institute, Proposed Final Draft, April 5, 1993) [hereinafter COMPLEX LITIGATION PROJECT].

<sup>39</sup> *Id.*

show no signs of attenuation, the ALI cites the words of United States District Judge Spencer Williams:

[S]tate and federal trial judges are being inundated with mass filings of lawsuits by individual plaintiffs, *each* seeking compensation and a share of large punitive damage awards, based on a single catastrophe or the mass production and sale by one defendant of a defective product. The long arms of these "big cases" . . . have ensnared virtually thousands of courts in this country in costly and repetitive litigation, threatening to last well into the next century. These cases are but the harbinger of the judiciary's role in an increasingly complex society, with huge multi-national corporations peddling their mass-produced consumer goods and drugs by instantaneous satellite communication. In such a society, it is not an overly pessimistic prediction that, absent some legislative or judicial solution, our attempt to try these virtually identical lawsuits, one-by-one, will bankrupt both the state and federal court systems.<sup>40</sup>

Although Judge Williams' dire predictions may seem far-removed from Mississippi's court system, a sampling of Mississippi cases demonstrates that the state judiciary faces the same complex litigation problems, albeit on a lesser scale, as do the federal courts. Mississippi courts have wrestled with cases ranging in subject matter from recent environmental mass tort cases<sup>41</sup> and liability for asbestos poisoning,<sup>42</sup> to the myriad of insurance-related claims brought, on similar issues, in the wake of Hurricane Camille in 1969.<sup>43</sup> Though the federal court system now adjudicates many of the complex cases spawned by

---

<sup>40</sup> *Id.* at 17 (quoting Hon. Spencer Williams, *Mass Tort Class Actions: Going, Gone?*, 98 F.R.D. 323, 324 (1983)).

<sup>41</sup> *Hubbard v. Leaf River Forest Prod., Inc.*, No. 91D-20-A (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed March 1, 1991, severed Aug. 27, 1992) (lawsuit by multiple plaintiffs alleging liability for injuries caused by dioxin and other chemicals discharged into Pascagoula and Leaf rivers).

<sup>42</sup> See *Asbestos Personal Injury Cases*, *supra* note 17.

<sup>43</sup> See, e.g., *Liberty Universal Ins. Co. v. Hall*, 289 So. 2d 683 (Miss. 1973); *Lunday v. Lititz Mut. Ins. Co.*, 276 So. 2d 696 (Miss. 1973). Though the two cases were tried in different circuit courts, they were appealed to the supreme court on similar questions of whether damage was caused by water, which was not covered by insurance, or was caused by the direct action of the wind, which was covered by insurance.

actions of Mississippi litigants, the potential for growth of complex litigation under state law equivalents remains.<sup>44</sup> While federal courts seem to have defended against the first waves of complex litigation, state judiciaries — including Mississippi's — should expect parallel growth in the field as they enter the 21st century.

### *B. Responses*

While Mississippi may still be fighting only the early skirmishes in the complex litigation war, judges, lawyers and lawmakers at the national level have battled burgeoning multi-party, multi-forum litigation for at least half a century. And though it may be tempting to view complex litigation as nothing more than the sum of complicated and multifarious cases, legislative and judicial responses to this expanding area of the law, particularly at the federal level, have been neither singular nor uncomplicated.

#### *1. Report of the Prettyman Commission*

Professors Marcus and Sherman trace judicial concern over "protracted" litigation to the late 1940s.<sup>45</sup> In 1949, in response to increasing anxiety over the rise of antitrust litigation, a commission headed by Judge E. Barrett Prettyman released a report focusing on problems that arose at trial, as well as problems of delay, over-discovery and expense.<sup>46</sup> The report addressed cases involving, "potentially, many issues, many defendants, hundreds of exhibits, thousands of pages of testimony, weeks or months of hearings, and hundreds of

---

<sup>44</sup> The Mississippi statute, for example, which authorizes private antitrust actions, is arguably more permissive than its federal counterpart. Compare 15 U.S.C. § 15(a) (1988 & Supp. II 1990) (allowing only actions for direct injury from antitrust violations) with MISS. CODE ANN. § 75-21-9 (1991) (allowing actions for indirect injuries by antitrust violations).

<sup>45</sup> MARCUS & SHERMAN, *supra* note 34, at 2-3.

<sup>46</sup> Hon. Leon R. Yankwich, "Short Cuts" In Long Cases — A Commentary on the Report Entitled Procedure in Antitrust and Other Protracted Cases Adopted by the Judicial Conference of the United States, September 26, 1951, 13 F.R.D. 41, 62 (1952).



thousands of dollars"<sup>47</sup> — all problems identical to those faced by today's judiciary (except for the dollar amounts, which seem miniscule in contrast to today's mass tort litigation). The Prettyman Commission viewed complicated litigation, with its potential for growth, as a multi-faceted problem with various adverse results:

Unnecessary consumption of time and energy, delay in disposition of disputes, and enormous expenditures of money are among the vices resulting from the circumstances described, but the principal vice is that such conditions create confusion, magnify uncertainty, multiply the possibilities of error, and otherwise tend to make less certain and less accurate the judicial determination of disputed issues.<sup>48</sup>

The Prettyman Report did not address problems such as aggregation, consolidation and state and federal overlap in complex cases, perhaps because of the almost exclusive anti-trust focus of the document. Instead, the Commission emphasized the role of the judiciary itself in managing complex cases. The report settled on pre-trial conferences as the best tool for judicial oversight, with the principal objective of such conferences being preparation for trial, stressing the importance of identification and specificity of issues to be tried, and the elimination of unnecessary material offered at trial.<sup>49</sup> The Report concluded:

That the most effective means of preventing unnecessary delay, volume of record, and expense are:

- (a) conferences between judge and counsel prior to trial, such conferences to be of a style and scope to meet the peculiar needs of the particular case;
- (b) the exclusion from the record of all unnecessary, as well as all irrelevant and incompetent, matter; and
- (c) a course of procedure which will minimize delay in the accurate disposition of the cause after the completion of the trial.<sup>50</sup>

---

<sup>47</sup> *Id.* at 63.

<sup>48</sup> *Id.* at 64.

<sup>49</sup> *Id.* at 67-68, 72.

<sup>50</sup> *Id.* at 84.

While the Prettyman Commission Report was a solid first effort to leash the growing complex litigation beast, it was only four years after the release of the Report that Chief Justice Warren appointed a panel of federal judges to revisit the special difficulties presented by pretrial organization and trial of complicated cases.<sup>51</sup> Five years later, the panel released a booklet entitled *Handbook of Recommended Procedures for the Trial of Protracted Cases*.<sup>52</sup>

## 2. *Handbook of Recommended Procedures for the Trial of Protracted Cases*

The Warren panel, with Judge Alfred P. Murrah as its Chairman, relied on the Prettyman and subsequent antitrust-oriented reports for its format,<sup>53</sup> but provided more detailed instructions to lawyers and judges for the handling of protracted cases. The handbook was far less interested in the causes, or even a precise definition of complex litigation,<sup>54</sup> than in providing practical guidance to practitioners. Covering over 125 pages (as published in the Federal Rules Decisions), the handbook addressed areas ranging from clerk identification of "big cases," to scheduling, to the use of expert testimony. It included a detailed appendix of sample forms designed to streamline identification, scheduling, discovery, and trial of both criminal and civil big cases.<sup>55</sup>

The handbook's basic thrust, like the Prettyman Report, was on single-court management of complex litigation, with judges utilizing anticipatory procedures to steer cases through various stages, from complaint through trial. Although its guidelines and simple, straightforward case management approach deserve consideration by today's judges and practitio-

---

<sup>51</sup> MARCUS & SHERMAN, *supra* note 34, at 3.

<sup>52</sup> 25 F.R.D. 351 (1960).

<sup>53</sup> *Id.* at 366. In the handbook's foreword, Judge Alfred Murrah writes "[f]or the most part, the topical arrangement of the Prettyman Report has been retained." *Id.*

<sup>54</sup> *Id.* at 375-76. In fact, the Warren Panel deliberately avoided hard and fast definitions, referring repeatedly throughout the handbook to, simply and accurately, the "Big Case." To the authors, this label seems about as good as any.

<sup>55</sup> *Id.* at 369.

ners entering the complex litigation melee, the handbook avoided issues of multi-district and multi-forum litigation.<sup>56</sup> The next step in big case solutions, the *Manual for Complex Litigation*, would address just such issues.

### 3. *The Manual for Complex Litigation*

When, in the late 1950s, nearly 2,000 private antitrust treble damage actions involving 25,000 claims had been brought in a single year in the wake of successful price-fixing prosecutions,<sup>57</sup> the federal judiciary was forced to confront the problems of multi-district complexities head-on. Chief Justice Warren appointed a Coordinating Committee for Multiple Litigation, whose job was to direct pretrial preparation of the antitrust cases.<sup>58</sup> As Marcus and Sherman note:

This effort was such a success that Congress enacted the Multidistrict Litigation Act in 1968, providing for the transfer of cases raising a common factual issue to one district for pretrial purposes. The pretrial transfer of such cases was to be handled by the Judicial Panel on Multidistrict Litigation, also created in 1968. The Panel, in turn, published the *Manual for Complex Litigation*, which first appeared in 1969 and has been amended from time to time since.<sup>59</sup>

---

<sup>56</sup> The panel did recommend assigning big cases to single judges:

Recommendation: Each big case should be assigned in its entirety to one judge for all purposes, including all pre-trial motions. In districts where actions are not automatically assigned on filing to a single judge, such assignment should be made by the Chief Judge as soon as the case has been identified as a big case. However, there is a caveat which should be borne in mind: the litigant in the shorter case, of course, is entitled to his day in court and resident judges should be given additional help as necessary to assure that needed attention will be given to shorter cases.

*Id.* at 377. No other provisions for consolidation or aggregation were made in the handbook.

<sup>57</sup> COMPLEX LITIGATION PROJECT, *supra* note 38, ch. 2, reporter's note to cmt. a at 11 (citing HOUSE JUDICIARY COMM. REP. NO. 1130, 90th Cong., 2d Sess. 2 (1968)).

<sup>58</sup> MARCUS & SHERMAN, *supra* note 34, at 3.

<sup>59</sup> *Id.* The Multidistrict Litigation Act is codified at 28 U.S.C. § 1407, and is considered "one of the most important tools for processing complex litigation that the federal system has developed to date." COMPLEX LITIGATION PROJECT, *supra* note 38, ch. 2, reporter's note to cmt. a at 12.



The most recent edition of the *Manual for Complex Litigation* is a comprehensive work aimed at "setting forth the basic principles that characterize the fair and efficient resolution of complex litigation, . . . describ[ing] various procedures that have successfully implemented those principles and identify[ing] certain practices that have caused difficulties."<sup>60</sup>

The contents of the manual cannot be sufficiently summarized — in its text of over 500 pages, the manual seems to address every conceivable facet of complex litigation, with specific guides to such areas as mass torts, securities litigation, employment discrimination, takeover litigation, and patent litigation.<sup>61</sup>

Even with such an extensive guide available, few would argue that the judiciary or the bar have found any long-term solutions to the continuing problems of multi-party, multi-forum complex litigation. The Multidistrict Litigation Panel, despite successes,<sup>62</sup> is restrained by statutory provisions that limit its authority to pretrial consolidation.<sup>63</sup>

### C. *The American Law Institute Complex Litigation Project*

The latest, and perhaps most comprehensive, guide in the complex litigation field is the ALI's *Complex Litigation Project*.<sup>64</sup> This manual, still in its "Proposed Final Draft" form as of April 5, 1993, includes five chapters on the scope and consolidation of complex litigation, and one chapter on choice of law.<sup>65</sup> In addition, the draft contains three appendices with model statutes for consolidation and management of complex

---

<sup>60</sup> MANUAL FOR COMPLEX LITIGATION, Second, § 10 (1985) [hereinafter MANUAL FOR COMPLEX LITIGATION].

<sup>61</sup> *Id.* at xvi.

<sup>62</sup> COMPLEX LITIGATION PROJECT, *supra* note 38, ch. 2, reporter's note to cmt. a at 12. The Multidistrict Litigation Panel had consolidated 17,918 separate civil actions for pretrial proceedings as of June 30, 1990. *Id.*

<sup>63</sup> *Id.* at 12, 28.

<sup>64</sup> COMPLEX LITIGATION PROJECT, *supra* note 38.

<sup>65</sup> Specific chapters are "Introduction and Scope of the Complex Litigation Project," "The Problem of Complex Litigation," "Federal Intrasystem Consolidation," "Consolidation in State Courts," "Federal-State Intersystem Consolidation, and "Choice of Law." COMPLEX LITIGATION PROJECT, *supra* note 38, at i.

cases. Chapter Four of the *Complex Litigation Project*, "Consolidation in State Courts," addresses two potential methods of consolidation of complex issues in state courts: (1) designation of state courts as a transferee forum for federal actions;<sup>66</sup> and (2) transfer and consolidation of litigation among the courts of different states.<sup>67</sup> Although the manual briefly notes that intrastate procedures for consolidation have been enacted by several individual states,<sup>68</sup> the chapter clearly focuses on federal-to-state and state-to-state transfers.

*1. Federal-to-State Transfer and Consolidation: Section 4.01*

The ALI proposes establishment of a "Complex Litigation Panel" which would designate state courts as transferee courts for certain complex litigation matters originally brought in federal courts.<sup>69</sup> Section 4.01 delineates factors to be considered in any federal-to-state transfer, and sets forth the following requirements before transfer may be effected:

- (1) that the events giving rise to the controversy are centered in a single state and a significant portion of the existing litigation is lodged in the courts of that state;
- (2) that fairness to the parties and the interests of justice will be materially advanced by transfer and consolidation of the federal actions with other suits pending in the state court; and
- (3) that the state court is superior to other possible transferee courts.<sup>70</sup>

The section further states that, for purposes of determining whether the above requirements are met, the Complex Litigation Panel should consider factors such as the following:

- (1) the number of the individual cases that initially were filed or are pending in state courts relative to the number of actions pending in federal courts;

---

<sup>66</sup> *Id.* § 4.01.

<sup>67</sup> *Id.* § 4.02.

<sup>68</sup> *Id.* ch. 4, reporter's notes to cmt. b, at 211 (citing CAL. CIV. PROC. CODE §§ 404-404.8 (1973 & Supp. 1993)).

<sup>69</sup> *Id.* § 4.01.

<sup>70</sup> *Id.*

- (2) the number of states in which the state and federal cases are located;
- (3) whether the procedures or law to be applied in the state transferee court differ from that which would have been applied by a federal transferee court to a sufficient degree that designation of the state transferee court creates a risk of prejudice to some of the parties to be transferred there; and
- (4) any other factor indicating the need to accommodate a particular state or federal interest.<sup>71</sup>

In addition, section 4.01 lists several exceptions to the transfer provisions and concludes with a statement that appellate review of federal actions transferred to state courts shall be in the state appellate courts.<sup>72</sup>

In the comment to the section, the drafters tacitly acknowledge that the proposal to transfer litigation from federal to state courts is potentially fraught with controversy, and should therefore be viewed as "a new and experimental procedure."<sup>73</sup> The drafters state that the procedure should be used only "in very limited situations in which the identification of the appropriate state transferee forum is clear because the events giving rise to the controversy are centered in a single state and a significant portion of the existing litigation already is lodged in the courts of that state."<sup>74</sup> But even with these caveats, the proposal is bound to face considerable challenges for both

---

<sup>71</sup> COMPLEX LITIGATION PROJECT, *supra* note 38, § 4.01.

<sup>72</sup> *Id.* The final sections of the rule read as follows:

(c) The Complex Litigation Panel shall not transfer to a state court any action that is within the exclusive jurisdiction of the federal courts, or any action that has been removed to a federal court under the provisions of 28 U.S.C. § 1441(d), 28 U.S.C. § 1442, or 28 U.S.C. § 1443, or brought in federal court under the provisions of 42 U.S.C. § 1983. In any action brought by the United States under 28 U.S.C. § 1345, or removed by it under 28 U.S.C. § 1444, the government shall have the right to be exempted from transfer to a state court.

(d) Other than as provided in § 3.07(b), appellate review in federal actions transferred for consolidation to a state court pursuant to this section shall be in the appellate courts of the state in which the transferee court sits.

*Id.*

<sup>73</sup> *Id.* § 4.01 cmt. a, at 221-22.

<sup>74</sup> *Id.* § 4.01 cmt. a, at 222.



philosophical and practical reasons, ranging from federalism concerns to individual litigators' preferences for federal adjudication.

## 2. *Interstate Transfer and Consolidation: Section 4.02*

The ALI's section 4.02 on interstate consolidation of complex litigation is largely aspirational in form:

Formulation of an Interstate Complex Litigation  
Compact or a Uniform Complex Litigation Act

In order to facilitate the transfer and consolidation of related litigation pending in the courts of different states and to promote the just, efficient, and economical resolution thereof, consideration should be given to the formulation of an Interstate Complex Litigation Compact or a Uniform Complex Litigation Act.<sup>75</sup>

In the comment to the section, the drafters acknowledge substantial "federalism and fairness reservations," but argue that some balance can be struck between those values and the goal of efficient resolution of complicated, nationwide disputes.<sup>76</sup> In a model proposal, the drafters lay out particular factors to be considered in striking such a balance, but note that states must take the initiative if state-to-state transfers of complex cases are to occur.<sup>77</sup>

---

<sup>75</sup> *Id.* § 4.02.

<sup>76</sup> *Id.* § 4.02 reporter's note to cmt. c, at 265.

<sup>77</sup> Appendix B is entitled "A Model System for State to State Transfer and Consolidation." While its contents are beyond the scope of this article, a quotation from section 1, entitled "Standard for Transfer and Consolidation," illustrates the nature of the proposed system:

(a) The Interstate Complex Litigation Panel established in § 2 may transfer and consolidate actions commenced in the courts of two or more states if:

(1) common questions of fact predominate, and

(2) transfer and consolidation will promote substantially the just, efficient, and fair conduct of the actions and is superior to their separate adjudication.

(b) Factors to be considered in deciding whether the standard set forth in subsection (a) is met include

(1) the extent to which transfer and consolidation will reduce duplicative litigation, the relative costs of individual and consolidated litigation, the likelihood of inconsistent adjudications, and the comparative burdens on the judiciary, and

#### IV. PROBLEMS AND SOLUTIONS IN MISSISSIPPI

The foregoing discussion of the complex litigation phenomenon from the historical perspective indicates that growth in methods to manage such litigation over the last fifty years has occurred somewhat haphazardly, where it has occurred at all. Even though the early focus for innovations to cope with complex litigation was on the federal system,<sup>78</sup> state courts have increasingly been called upon to handle complex cases.<sup>79</sup> In some instances, mass or complex cases must be brought in state courts because of lack of complete diversity or failure to meet the jurisdictional amount requirement,<sup>80</sup> but regardless

---

(2) whether transfer and consolidation can be accomplished in a way that is fair and does not result in undue inconvenience to the parties and witnesses.

In considering those factors, account may be taken of matters such as

- a. the number of parties and actions involved;
- b. the geographic dispersion of the actions;
- c. the existence and significance of local concerns;
- d. the subject matter of the dispute;
- e. the amount in controversy;
- f. the significance and number of common issues that are involved, including whether multiple laws will have to be applied to those issues;
- g. the likelihood of additional related state actions being commenced in the future;
- h. the wishes of the parties; and
- i. the stages to which the actions already commenced have progressed.

(c) Transfer and consolidation need not be denied simply because one or more of the issues are not common so that consolidated treatment of all parts of the dispersed actions cannot be achieved. Although the Panel typically shall transfer and consolidate entire cases, in special circumstances it may transfer and consolidate one or more common issues, rather than entire cases.

COMPLEX LITIGATION PROJECT, *supra* note 38, App. B, § 1, at 564-66.

<sup>78</sup> See RICHARD L. MARCUS & EDWARD F. SHERMAN, *COMPLEX LITIGATION: CASES AND MATERIALS ON ADVANCED CIVIL PROCEDURE* 6-9 (2d ed. 1992) (for brief description of special problems created in federal courts by escalation of complex litigation from late 1940's until present and tensions which have arisen as federal judges have turned to innovative techniques for aggregative disposition).

<sup>79</sup> COMPLEX LITIGATION PROJECT, *supra* note 38, ch. 4, introductory note at 205.

<sup>80</sup> *Id.* Diversity jurisdiction is often impeded in class actions because plaintiffs may not aggregate their claims to meet the jurisdictional amount requirement. *Synder v. Harris*, 394 U.S. 332 (1969), *reh'g denied*, 394 U.S. 1025 (1969). Furthermore, all class

of whether such actions *must* be brought in state court, there are compelling reasons why some such actions are better suited for resolution in a state court system.

"Single disaster" events, pollution cases, and insurance coverage disputes have been cited as examples of cases that lend themselves to adjudication in state court.<sup>81</sup> Serious federalism concerns arise when mass tort litigation is forced into the federal system.<sup>82</sup> The handling of such cases sets the stage for the development or refinement of substantive state law as well as the study and potential alteration of a state's system of civil procedure. State judges should be the decision-makers and authors in matters of such importance to a state.

The multi-state nature of many, if not most, examples of complex litigation has spawned much literature and some legislation aimed at creating procedures which will allow federal or state courts to aggregate or consolidate cases for efficiency purposes. The nature of the complex litigation beast will often create a situation where related cases are pending in state courts of various states and in two or more federal court districts.

The purpose of this portion of the article is to examine the major problem areas of such litigation as identified by past and existing litigation and to discuss case management devices which appear to be available to state trial judges as well as to attorneys for plaintiffs and defendants to help order and expedite such litigation. The following subsections will analyze existing Mississippi law in the mass tort context with regard to basic procedural matters pertaining to venue, parties, discovery, and trial. The potential for change or addition to existing procedures will be discussed when warranted by a comparison of Mississippi procedures to those of other jurisdictions.

---

members must individually meet the jurisdictional amount requirement. *Zahn v. International Paper Co.*, 414 U.S. 291 (1973).

<sup>81</sup> COMPLEX LITIGATION PROJECT, *supra* note 38, ch. 4, reporter's note to comment a, at 209.

<sup>82</sup> See, e.g., *In Re Joint E.&S. Dist. Asbestos Litig.*, 129 B.R. 710, 877-78 (Bankr. S.D.N.Y. 1991), *vacated*, 982 F.2d 721 (2d Cir. 1992).



A. *Coordination by Transfer of Venue or Change of Court*

Aggregation or coordination of cases filed within one state may be desirable, but before such coordination can be achieved, the venue scheme of the state must permit case transfer to the unitary county. In dealing with aggregation of interstate cases, the federal system has to cope with the minimum contacts and due process concerns of the fourteenth amendment, but within a given state, any perceived impediments to aggregation of geographically dispersed cases may be solved by the state legislature.<sup>83</sup>

1. *The Existing Venue Scheme in Mississippi*<sup>84</sup>

Venue in Mississippi is established by statute.<sup>85</sup> Plaintiffs may properly commence circuit court actions against resident individual defendants in the county in which the cause of action may occur or accrue or in the county in which the defendant may be found.<sup>86</sup> Domestic corporations may be sued in the county of their domicile or in the county in which the cause of action may occur or accrue.<sup>87</sup> Nonresidents may be sued in the county in which the action accrued or in the county where the plaintiff then resides or is domiciled.<sup>88</sup> Chancery court actions may be brought in the county where the defendant may reside or be found.<sup>89</sup> If venue is proper for one defendant, then all

---

<sup>83</sup> Robert W. Kastenmeier & Charles G. Geyh, *The Case in Support of Legislation Facilitating the Consolidation of Mass-Accident Litigation: A View from the Legislature*, 73 MARQ. L. REV. 535, 539 (1990).

<sup>84</sup> For a full discussion of civil venue in Mississippi with some suggestions for change, see Guthrie T. Abbott, *Venue of Transitory Actions Against Resident Individual Citizens in Mississippi — Statutory Revision Could Remove Needless Complexity*, 58 MISS. L.J. 1 (1988).

<sup>85</sup> MISS. R. CIV. P. 82(b) states in pertinent part: "Venue of Actions. Except as provided by this rule, venue of all actions shall be as provided by statute." *Id.*

<sup>86</sup> MISS. CODE ANN. § 11-11-3 (Supp. 1993).

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* § 11-11-11 (1972).

<sup>89</sup> *Id.* § 11-5-1 (1972).

defendants may be forced to defend in the county chosen by plaintiff as proper for the one material defendant.<sup>90</sup>

The dioxin cases alleging pollution of rivers and streams in south Mississippi offer a good example of problems which may exist in our Mississippi venue scheme if coordination were desired of numerous cases with some common questions of fact or law. As of April 1, 1993, 211 such cases involving 8837 plaintiffs were pending in five south Mississippi counties.<sup>91</sup>

---

<sup>90</sup> *Senatobia Community Hosp. v. Orr*, 607 So. 2d 1224 (Miss. 1992). In a medical malpractice suit against a hospital and three doctors, plaintiff brought suit in the plaintiff's home county when a doctor-defendant moved from Mississippi to Louisiana. *Id.* at 1225-26. Venue was fixed by plaintiff in reliance upon § 11-11-11 of the Mississippi Code. *Id.* at 1226. The hospital and the other two doctor-defendants were all domiciled in Mississippi and venue was not proper for any of them in plaintiff's home county. *Id.* In this case of first impression as to whether the resident defendants could be sued in plaintiff's home county because a nonresident defendant was a party to the suit, the Court applied the general rule that "where venue is good as to one defendant, it is good as to all defendants." *Id.* (citing *Blackledge v. Scott*, 530 So. 2d 1363, 1365 (Miss. 1988)).

<sup>91</sup> These figures are contained in a notebook submitted by defendants Georgia-Pacific Corp., et al, to Circuit Judge James W. Backstrom in response to Judge Backstrom's order of March 29, 1993, in *In Re: Mississippi Dioxin Litigation* (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist.). The order reads as follows:

#### ORDER

By \_\_\_\_\_ D.C.

In order to acquaint the undersigned Circuit Court Judge (who was just recently assigned these dioxin cases) with the dioxin litigation counsel for the plaintiffs and the defendants are directed to furnish to such judge within thirty days the following information:

- (a) a chronology of major events of the dioxin litigation from the perspective of the respective parties;
- (b) the style, civil action number, where filed, the number of plaintiffs, and the defendants in those cases;
- (c) the nature of the claims in those cases; *i.e.*, property owners, non-property owners, etc.;
- (d) any other information or recommendations that counsel believe will be pertinent to the expeditious handling of these cases.

Counsel for the parties may submit the above information jointly in order to avoid duplication if they so desire.

SO ORDERED on this the 29th March, 1993.

s/James W. Backstrom  
JAMES W. BACKSTROM  
CIRCUIT COURT JUDGE

Assuming that coordination of these actions before one judge *in one county* might promote judicial efficiency, the question is whether the current Mississippi venue rules will permit the transfers needed to accomplish such coordination. A companion problem exists when cases are pending in different courts as well as in different counties. Four of the dioxin suits with nine plaintiffs were pending in the Chancery Court of Perry County, Mississippi.<sup>92</sup> The circuit court actions were spread among George, Greene, Jackson, Jones, Harrison and Perry counties.<sup>93</sup>

Existing Mississippi statutes on venue leave no doubt that transitory claims *must* be brought in a county delineated as proper by statute.<sup>94</sup> Defendants may waive objections to venue in transitory actions either by overt action or by failure to make a timely objection to improper venue,<sup>95</sup> but upon timely objection, the suit *shall* be transferred to the proper county.<sup>96</sup> A fairly recent line of cases from the Mississippi Supreme Court has permitted transfer of venue based upon forum non conveniens principles,<sup>97</sup> but that doctrine has very limited application since the order to transfer venue may only effect a transfer from one county where venue is proper to another county where venue is also proper.<sup>98</sup>

---

<sup>92</sup> *In Re: Mississippi Dioxin Litigation* (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist.), at Ex. B-2.

<sup>93</sup> *Id.*

<sup>94</sup> See MISS. CODE ANN. § 11-11-3 (Supp. 1993); *Flight Line, Inc. v. Tanksley*, 608 So. 2d 1149, 1155 (Miss. 1992).

<sup>95</sup> *Belk v. State Dept. of Pub. Welfare*, 473 So. 2d 447, 449 (Miss. 1985).

<sup>96</sup> MISS. R. CIV. P. 82(d) states:

**Improper Venue.** When an action is filed laying venue in the wrong county, the action shall not be dismissed, but the court, on timely motion, shall transfer the action to the court in which it might properly have been filed and the case shall proceed as though originally filed therein. The expenses of the transfer shall be borne by the plaintiff. The plaintiff shall have the right to select the court to which the action shall be transferred in the event the action might properly have been filed in more than one court.

<sup>97</sup> See generally *Flight Line, Inc. v. Tanksley*, 608 So. 2d 1149 (Miss. 1992); *Missouri Pac. R.R. v. Tircuit*, 554 So. 2d 878 (Miss. 1989); *Board of Trustees v. Van Slyke*, 510 So. 2d 490 (Miss. 1987); *Illinois Cent. Gulf R.R. v. Stedman*, 344 So. 2d 468 (Miss. 1977).

<sup>98</sup> For treatment of the development of intrastate forum non conveniens in Mississippi see Abbott, *supra* note 84, at 12-19 (1988).



A large number of the dioxin claims include a count for trespass on real property.<sup>99</sup> In many jurisdictions, such a claim might be classified as a "local action" and venue would be limited to the county where the property is located. However, in the late 1800s, the Mississippi Supreme Court announced that the common-law distinction between local and transitory actions does not exist here<sup>100</sup> and that the only local actions are those established by statute.<sup>101</sup> The local actions named in the circuit court venue statute are "trespass on land, ejectment and actions for the statutory penalty for cutting and boxing trees and firing woods and actions for the actual value of trees cut."<sup>102</sup> A recent asbestos case filed in state court in Mississippi and removed to federal court has given the Fifth Circuit Court of Appeals an opportunity to make clear that the "local action" designation will have no application to most mass tort claims. In *Trust Co. Bank v. U.S. Gypsum Co.*,<sup>103</sup> the Fifth Circuit discussed the interstate aspects of "local actions" before determining that an action based on a contractor's use of fire-proofing materials in a construction project in Atlanta, Georgia was a transitory action under Mississippi decisions.<sup>104</sup> The court found that such actions require an act directly involved with the real property, as opposed to a wrongful act disconnected from the land which merely causes damage to the land, before the statutory "local action" trespass test is met.<sup>105</sup> However, even though the "local action" concept should have limited, if any, application to mass tort litigation, there is no procedural machinery currently available which authorizes transfer of transitory actions dispersed in counties throughout the state to one county in one court under the general direction

---

<sup>99</sup> See Judge James W. Backstrom's Order of March 29, 1993, *supra* note 91, at Ex. C-2.

<sup>100</sup> *Archibald v. Mississippi & T.R.*, 6 So. 238, 239 (Miss. 1889).

<sup>101</sup> See MISS. CODE ANN. § 11-11-3 (Supp. 1993) (concerning Circuit Court); MISS. CODE ANN. § 11-5-1 (1972) (concerning Chancery Court).

<sup>102</sup> MISS. CODE ANN. § 11-11-3 (Supp. 1993).

<sup>103</sup> 950 F.2d 1144, 1148-50 (5th Cir. 1992).

<sup>104</sup> *Id.* at 1150 (citing *Archibald*, 6 So. at 238-39).

<sup>105</sup> *Id.*

of one judge.<sup>106</sup> In order to achieve such aggregation, authority would have to be placed in some entity which permitted both transfer of venue and transfer from county, circuit or chancery court to the particular court in which the cases were to be consolidated.

## 2. *The California Coordination Procedures*

California has established the model for state-wide *coordination* of related cases. It should be made clear that *consolidation* of actions pending before a court under Mississippi Rule of Civil Procedure 42(a) is a very different procedure from the coordination process which will be discussed below. Coordination began in California in 1974 as a method of joining cases pending in different counties and was amended in 1982 to allow joinder in the California Superior Court of cases pending in lower level courts.<sup>107</sup> The California vernacular terms cases in varying venues to be "horizontally" different and cases in different courts to be "vertically" different.<sup>108</sup> In appropriate circumstances, the California statutory scheme will allow transfer of cases having a common question of fact or law from "horizontal" venues and "vertical" courts in order to coordinate the cases. The California statutes are brief and appear workable. The Mississippi legislature might do well to study the California approach with an eye toward emulating the same.

When civil actions sharing a common question of law or fact are pending in different California courts, either horizontally or vertically, the judge or a party to any such action may request the chairman of the Judicial Council to assign a judge

---

<sup>106</sup> The Judicial Questionnaire, *supra* pp. 103-04 asked Mississippi trial judges to "describe any transfers of venue ordered in complex cases to achieve aggregation or consolidation." One Hinds County Judge responded: "I know of no transfers for consolidation to other venues and do not know that that would be consistent with our rules of procedure giving the plaintiff [the right] to choose venue." *Id.*

<sup>107</sup> Darren L. Brooks, *California Practicum: A Guide to Coordination of Civil Actions in California*, 19 PEPP. L. REV. 163-64 (1991).

<sup>108</sup> *Id.* at 164.

to determine whether coordination is appropriate.<sup>109</sup> The obvious goal of coordination as stated in section 404.1 of the California Act<sup>110</sup> is "to promote the ends of justice," and the judge assigned to rule on coordination is mandated by the statute to consider the following factors:

- (a) whether the common question of fact or law is pre-dominating and significant to the litigation
- (b) the convenience of parties, witnesses and counsel
- (c) the relative development of the actions and the work product of counsel
- (d) the efficient utilization of judicial facilities and manpower
- (e) the calendar of the courts
- (f) the disadvantages of duplicative and inconsistent rulings, orders or judgments
- (g) the likelihood of settlement of the actions without further litigation should coordination be denied.<sup>111</sup>

If coordination is ordered, the cases are transferred to "one judge hearing all of the actions for all purposes in a selected site or sites."<sup>112</sup> Ordinarily, the California state court coordination begins before or during the discovery stage and persists through the final disposition of all of the cases.<sup>113</sup> Therefore, such coordination within a state differs markedly from its federal counterpart, multidistrict litigation, which combines cases pending in different districts for pre-trial purposes only.<sup>114</sup>

It is suggested that Mississippi will not have many parcels of litigation which might be deemed suitable for coordination under the criteria set forth above. However, litigation which does fit the model will likely involve thousands of parties and numerous attorneys and judges, thereby potentially causing enormous problems in Mississippi's judiciary system. The very

---

<sup>109</sup> CAL. CIV. PROC. CODE § 404 (Supp. 1993).

<sup>110</sup> *Id.* § 404.1.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> See Brooks, *supra* note 107 at 165.

<sup>114</sup> *Id.*



brief California legislation,<sup>115</sup> with its companion set of rules adopted by the Judicial Council of California,<sup>116</sup> seems to establish a common sense approach to a growing problem. The criteria to be met before usage indicates how circumscribed the instances of application should be, but it is submitted that state-wide coordination is a tool which Mississippi judges might use to craft some enduring works of justice.

Obviously, there are differences between the Mississippi and California judicial systems, but those differences could be easily reconciled if Mississippi chooses to adopt a system for coordination. The Chief Justice of the Mississippi Supreme Court could take a role analogous to the chairman of the California Judicial Council in assigning a judge to determine whether coordination is appropriate. The "vertical" description of transfer in California does not accurately describe the circuit-chancery dichotomy in Mississippi, but it does characterize our county court situation. The authors see no problems in orders of transfers from one type of court to another for purposes of coordination so long as there is a basis for jurisdiction in the transferee court. An analysis of the previous and existing mass tort cases in Mississippi indicates that most of the cases are filed in circuit court (or on the law side of county court) and that the cases filed in chancery court have a basis for circuit court jurisdiction as well as an independent basis for chancery jurisdiction. If an in-depth study of coordination revealed jurisdictional problems regarding matters such as attachment in chancery court, the problems could be solved by the legislation creating coordination procedures, unless there were a state constitutional mandate involved. However, no such constitutional mandate appears to exist.

---

<sup>115</sup> CAL. CIV. PROC. CODE §§ 404-404.8 (1973 & Supp. 1993).

<sup>116</sup> For a detailed discussion of the steps involved in coordination of cases in California, see Brooks, *supra* note 107, at 171-89.

*B. Class Actions in Mississippi as a Response to Mass Tort Complex Litigation*

Mississippi has no statutorily-sanctioned class action procedures.<sup>117</sup> In fact, even prior to the Mississippi Supreme Court's adoption of the Mississippi Rules of Civil Procedure, the Court had only allowed use of class action certification in limited proceedings. In each case where class treatment was allowed by the Mississippi Supreme Court, plaintiffs sought injunctive or other equitable relief in chancery court against governmental entities.<sup>118</sup> Nevertheless, any evaluation of mass tort litigation in this state would be deficient absent some discussion of the potential use of class actions as a tool for complex case management.

*1. The Leaf River Case*

One of the myriad of recent dioxin cases in South Mississippi provides a good example of circuit court treatment of plaintiffs' requests for class action certification in cases involving multiple plaintiffs and defendants in a complex litigation/mass tort case. In *Hubbard v. Leaf River Forest Products, Inc.*,<sup>119</sup> plaintiffs sought to maintain a class action against Leaf River Forest Products and certain of its affiliates and employees for polluting the Leaf and Pascagoula Rivers. Three subclasses sought class certification: (1) riparian property owners and lessees along the Leaf and Pascagoula Rivers; (2) persons who have owned or operated businesses dependent upon the vitality of the Leaf and Pascagoula Rivers;

---

<sup>117</sup> See MISS. R. CIV. P. 23 (entitled "Class Actions [Omitted]").

<sup>118</sup> See, e.g., *Brown v. Reeves*, 92 So. 825 (Miss. 1922) (permitting taxpayers to recover for county appropriations wrongfully expended); *Jones v. Mayor of Jackson*, 61 So. 456 (Miss. 1913) (without specifically addressing class actions, court permitting taxpayer to enjoin diversion of dedicated property).

<sup>119</sup> No. 91D-20-A (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed March 1, 1991, severed Aug. 27, 1992).

and (3) persons who have eaten fish from or used the Leaf or Pascagoula River for recreational purposes.<sup>120</sup>

Defendants in the case argued for denial of class certification on a number of grounds.<sup>121</sup> First, they pointed out that there was no provision for class actions in the Mississippi Rules of Civil Procedure and that the only judicially sanctioned use of class actions had been in equity proceedings.<sup>122</sup> Second, they claimed that even under Rule 23 of the Federal Rules of Civil Procedure, the present case, as a mass tort action, would not qualify for class status.<sup>123</sup> They argued that the two threshold requirements — (1) that the class definition not be so vague or difficult to apply that members of the class could not be clearly identified; and (2) that the named representative have the same interest and have suffered the same injury as the class — were not met in the case.<sup>124</sup> They claimed that the “class of persons who have eaten fish from the River, or who have used the River for recreational purposes” is hopelessly overbroad, and therefore, the class could not be identified with objective certainty.<sup>125</sup> Relative to the requirement of the representative having the same interest and injury as the class, they noted that the named plaintiffs in this case did not operate a business, did not own riparian property, and sought no recovery of such losses.<sup>126</sup> As a result, the defendants maintained that the named plaintiffs were not suitable class representatives.<sup>127</sup>

Third, the defendants outlined the particular requirements of Federal Rules of Civil Procedure 23(a) and argued that the

---

<sup>120</sup> *Id.* (Defendants' Proposed Findings of Fact and Conclusions of Law on Plaintiffs' Motion to Maintain Class Action, For Certification of Class Action and for Notice to Class Members at 1).

<sup>121</sup> *Hubbard v. Leaf River Forest Prods., Inc.*, No. 91D-20-A (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., filed March 1, 1991, severed Aug. 27, 1992) (Defendant's Brief in Opposition to Motion for Class Certification) [hereinafter *Defendant's Brief*].

<sup>122</sup> *Defendant's Brief*, *supra* note 121, at 1-2; see also *supra* note 120 and accompanying text.

<sup>123</sup> *Defendant's Brief*, *supra* note 121, at 2.

<sup>124</sup> *Id.* at 12.

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at 13.

<sup>127</sup> *Id.*



class was not so numerous that joinder was impracticable,<sup>128</sup> there were no substantial questions of law or fact common to the class,<sup>129</sup> the claims of the plaintiffs were not typical of the claims of the class,<sup>130</sup> and the plaintiffs would not fairly and adequately represent the class.<sup>131</sup> Likewise, the defendants claimed that the proposed class and its representatives did not meet the requirements of Federal Rules of Civil Procedure 23(b).<sup>132</sup> They asserted that common questions did not predominate over issues affecting only individual members,<sup>133</sup> a class action was not superior to other available means of handling the controversy,<sup>134</sup> and constitutionally mandated notice requirements were not clearly met in the case.<sup>135</sup> Finally, the defendants noted that the drafters of Rule 23 seemed to make clear that Rule 23(b)(3)<sup>136</sup> was not available for use in mass tort cases:

A "mass accident" resulting in injuries to numerous persons is ordinarily not appropriate for a class action because of the likelihood that significant questions, not only of damages but of liability and defenses of liability, would be present, affecting the individuals in different ways. In these circumstances an

---

<sup>128</sup> *Id.* at 13 (citing FED. R. CIV. P. 23(a)(1)).

<sup>129</sup> *Id.* (citing FED. R. CIV. P. 23(a)(2)).

<sup>130</sup> *Id.* at 17 (citing FED. R. CIV. P. 23(a)(3)).

<sup>131</sup> *Id.* at 20 (citing FED. R. CIV. P. 23(a)(4)).

<sup>132</sup> *Id.* at 24.

<sup>133</sup> *Id.* at 25 (citing FED. R. CIV. P. 23(b)(3)).

<sup>134</sup> *Id.* at 27-28 (citing FED. R. CIV. P. 23(b)(3)(A)-(D)).

<sup>135</sup> *Id.* at 30-31.

<sup>136</sup> FED. R. CIV. P. 23(b)(3) reads in pertinent part:

**(b) Class Actions Maintainable.** An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

....

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. [The section concludes with "matters pertinent to the findings."]

action conduct[ed] nominally as a class action would degenerate in practice into multiple lawsuits separately tried.<sup>137</sup>

## 2. *Current Status of Rule 23 in Mississippi and Judicial Survey Results*

Although the trial judge granted the plaintiffs' request for class certification in the *Leaf River* case,<sup>138</sup> the Mississippi Supreme Court reversed without actually reaching the merits of the class action question.<sup>139</sup> Thus, after *Leaf River*, the question of whether class actions may be a tool for managing complex cases in Mississippi remained unanswered. However, in the recent decision of *Marx v. Broom*,<sup>140</sup> the Mississippi Supreme Court answered this question, stating:

In enacting the Rules of Civil Procedure, this Court intentionally omitted Rule 23, which would have covered class actions. The comments to the Rules clearly state: "*Class action practice is not being introduced into Mississippi trial courts at this time.*" *This has not changed.*<sup>141</sup>

Despite the *Marx* decision, there are signs that federal court reticence to grant class action status in mass tort cases is eroding,<sup>142</sup> creating the possibility that, were the Mississippi Supreme Court to adopt a state equivalent to Rule 23, the procedure could be used in complex/mass tort litigation.

---

<sup>137</sup> *Defendants' Brief*, *supra* note 121, at 26 (quoting FED. R. CIV. P. 23(b)(3) advisory committee's note to 1966 amendment).

<sup>138</sup> *Ferguson v. Leaf River Forest Prod., Inc.*, No. 91D-20 (Miss. Cir. Ct. Jackson Cty., 19th Jud. Dist., Oct. 20, 1992) (order allowing class action).

<sup>139</sup> *Leaf River Forest Prod., Inc. v. Hubbard*, No. 92-M-1160 (Miss. Sup. Ct., Oct. 7, 1993) (order vacating class action on grounds that entry of such order was beyond trial judge's authority under his special appointment).

<sup>140</sup> No. 91-CC-00475, 1994 WL 52850 (Miss. Feb. 24, 1994).

<sup>141</sup> *Marx*, 1994 WL 52850 at \*7 (emphasis added). The supreme court did note that prior to the enactment of the Rules of Civil Procedure, a Mississippi decision had recognized "the possibility of class action suits as a matter of general equity jurisdiction in chancery court under limited circumstances." *Id.* (citing *Barrett v. Couillet*, 263 So. 2d 764 (Miss. 1972)).

<sup>142</sup> *See, e.g., Watson v. Shell Oil Co.*, 979 F.2d 1014 (5th Cir. 1992), *reh'g en banc granted*, 990 F.2d 805 (5th Cir. 1993) (finding no abuse of trial court's discretion in granting class certification in mass tort litigation arising from refinery explosion involving more than 18,000 plaintiffs).

In the authors' survey of Mississippi circuit, chancery and county judges, twenty of the twenty-five judges expressing an opinion on the issue felt that Mississippi should adopt a Rule 23 permitting class action litigation. One circuit judge responded as follows: "Yes; such would save courts' time, result in prompt handling of claims and bring about consistent results, and result in all parties receiving at least a part of [their] claim thereby preventing unjust distribution where the early cases exhausted the assets of culpable defendants." A chancery judge was even more emphatic in his support of a class action procedure in Mississippi: "My opinion is that we desperately should [adopt a Rule 23]. Costs of independent litigation are sky-high. Justice is denied when costs, attorneys fees, etc. are so high that a litigant can't raise suit money, or appeal deposit. Combining ability to pay helps." And even a county judge who had handled no complex litigation in his courtroom felt a state class action procedure was in order:

While as a County Court Judge the issue of complex/mass tort litigation does not have much impact because of the \$50,000 jurisdiction limit, I recognize the significant problems facing our Circuit and Chancery Courts and I believe the time has come to address the issue permitting class action litigation or be prepared to have tremendous backlogs of cases (ex. Jackson Co.) and judges who are tremendously overworked.

But support for state class action procedures is not unanimous, as two judges expressed concern over current courts' ability to properly administer a Rule 23. Typical of the comments of those opposed to adoption of class actions was the following:

While I feel that we are perhaps approaching the point in Mississippi state court practice where a Rule 23 would be beneficial, I would not like to have a Rule 23 until the state trial judges could be assured an adequate support staff, such as secretaries, law clerks, and possibly even magistrates, to assure that a Rule 23 could be properly utilized by the state trial courts.

In summary, though there seems to be substantial agreement among the responding judges that some sort of state class action procedure is in order, the availability of class actions



would add a new burden to the judicial load that some judges feel courts are currently unprepared to shoulder. Before enactment of such a pronounced change in the present procedural system, the Mississippi Supreme Court would do well to examine the effectiveness of Rule 23 in other states,<sup>143</sup> with particular emphasis on the rule's application to mass tort/complex litigation cases. Finally, it must be remembered that Rule 23 has been no panacea to the growing problems of complex litigation at the federal level, and one should expect the effectiveness of class actions at the state level to depend largely on their success in a larger complex litigation remedial scheme.

### C. *Special Masters in Complex Cases*

The use of special masters to aid with case management in complex cases throughout the nation has grown in recent years.<sup>144</sup> In federal courts, special masters may be appointed to undertake a wide range of duties which can assist the judge by conserving judicial time and energy or by adding needed expertise to the court. Federal judges may rely on Rule 53 of the Federal Rules of Civil Procedure and other authorities to make such appointments.<sup>145</sup> Although a debate continues over the efficacy of the special master in general civil litigation,<sup>146</sup> powerful arguments have been made for the need of special masters in complex cases, especially at the pretrial stage.<sup>147</sup>

---

<sup>143</sup> See, e.g., ALA. R. CIV. P. 23 (corresponding to FED. R. CIV. P. 23).

<sup>144</sup> Wayne D. Brazil, *Special Masters in Complex Cases: Extending the Judiciary or Reshaping Adjudication?*, 53 U. CHI. L. REV. 394 (1986) [hereinafter *Special Masters in Complex Cases*].

<sup>145</sup> For detailed treatment of the authority to appoint masters in federal court, see David I. Lavine, *The Authority for the Appointment of Remedial Special Masters in Federal Institutional Reform Litigation: The History Reconsidered*, 17 U.C. DAVIS L. REV. 753 (1984).

<sup>146</sup> See WAYNE D. BRAZIL ET AL., *MANAGING COMPLEX LITIGATION: A PRACTICAL GUIDE TO THE USE OF SPECIAL MASTERS*, 25 (1983).

<sup>147</sup> See Hazard & Rice, *Judicial Management of the Pretrial Process in Massive Litigation: Special Masters as Case Managers*, in BRAZIL ET AL., *supra* note 146, at 77. The authors give a detailed account of their roles as special masters in the massive antitrust litigation which brought about the restructuring of AT&T. See *United States v. American Telephone & Co.* (Civil Action No. 74-1698) (D. C. C., filed Nov. 20, 1974).

"Special master" is a term commonly used in the pretrial process of the federal judicial system to refer to an experienced private attorney, a retired judge, or a law professor to whom the court delegates responsibility either for the entire discovery stage or for specified, discrete tasks. The special master serves as an arm of the federal judge which the court can use in a wide variety of ways to deal with the demands made on strained judicial resources by pretrial preparation of large lawsuits.<sup>148</sup> The emerging role of the special master in massive modern litigation is well described as follows:

Not surprisingly, courts have used masters most ambitiously in the most complex, resource-threatening cases. Three types of cases are prototypical: mass torts (such as actions involving asbestos, Agent Orange, or DDT), massive commercial litigation, and public law cases requiring courts to fashion and implement equitable decrees that cover complex institutional relationships and extend over considerable periods of time.

In mass tort and complex commercial cases, courts have used masters for a wide range of purposes. The most significant uses have involved attempts to rationalize and streamline the process of generating the data necessary to determine liability and damages, as well as attempts to help the parties negotiate settlements.<sup>149</sup>

What appears to be the first attempt to use a special master in the manner described above in the state courts of Mississippi has exposed a weakness in the Mississippi procedures. On June 21, 1991, Circuit Judge Darwin Maples entered an order appointing Professor Francis E. McGovern of the University of Alabama School of Law as a special master to coordinate case management for all dioxin cases pending in the Nineteenth Circuit Court District of Mississippi. As of January 1, 1992, there were approximately 8,230 plaintiffs' claims pending in the dioxin litigation in state courts in south

---

<sup>148</sup> BRAZIL ET AL., *supra* note 146, at 5.

<sup>149</sup> *Special Masters in Complex Litigation*, *supra* note 144, at 397-98 (citations omitted).

Mississippi.<sup>150</sup> Professor Francis E. McGovern is a noted author in the area of mass tort/complex litigation<sup>151</sup> and has achieved a national reputation as an expert in the field. Also, Professor McGovern has served as a special master in other complex cases throughout the United States.<sup>152</sup> Unfortunately, the restrictive nature of Mississippi Rule of Civil Procedure 53 has denied the state the value of either a debate over the efficacy of such an appointment or the experience of observing such a special master in action. Mississippi Rule of Civil Procedure 53(b) states:

Qualifications. The master *shall be an attorney at law, authorized to practice law before all courts of the State of Mississippi*. However, in extraordinary circumstances where the finding to be made is of a complex, technical, non-legal nature, a person other than an attorney possessing the requisite qualifications of a person skilled in the field, area, or subject of the inquiry may be appointed as a master; additionally, persons other than attorneys may be appointed as special commissioners to conduct judicially-ordered sales and partitions of real or personal property.<sup>153</sup>

On August 13, 1991, another judge of the Nineteenth Circuit Court District entered an order declaring that the June 21, 1991, order appointing Professor McGovern as special master to coordinate case management of the dioxin cases was void *ab initio* because Professor McGovern was not an attorney authorized to practice in Mississippi. The Federal Rules of Civil

---

<sup>150</sup> Dioxin notebook submitted to J. Backstrom, *supra* note 91.

<sup>151</sup> See, e.g., Francis E. McGovern, *Resolving Mature Mass Tort Litigation*, 69 B.U.L. REV. 649 (1989); Francis E. McGovern, *Toward a Functional Approach for Managing Complex Litigation*, 53 U. CHI. L. REV. 440 (1986); Francis E. McGovern, *Management of Multiparty Toxic Tort Litigation: Case Law and Trends Affecting Case Management*, 19 FORUM 1 (1983).

<sup>152</sup> Francis E. McGovern, *Toward a Functional Approach for Managing Complex Litigation*, 53 U. CHI. L. REV. 440, 442 n.10 (1986). Professor McGovern served as a special master in *United States v. Michigan*, 471 F. Supp. 192 (W. D. Mich. 1979), modified, 653 F.2d 277, cert. denied, 454 U.S. 1124 (1981). In addition, Professor McGovern designed procedures for the use of appellate experts in the Alabama utility rate-making cases and he was appointed and served as a special master in the Ohio asbestos litigation.

<sup>153</sup> MISS. R. CIV. P. 53(b) (emphasis added).



Procedure do not require that a special master be an attorney,<sup>154</sup> and the utilization of masters seems to be successful in the federal arena.<sup>155</sup>

Both the federal and Mississippi rules of civil procedure mandate that reference to a master "shall be the exception and not the rule."<sup>156</sup> The authors are well aware that referring substantial pretrial matters to a master can involve great expense<sup>157</sup> and that any procedure permitting such reference should call for close scrutiny and careful analysis before permitting such a referral. However, it seems clear that there are and will be complex/mass tort cases in Mississippi courts in which the appointment of a master who is not an attorney authorized to practice in Mississippi, as required by Mississippi Rule of Civil Procedure 53(b),<sup>158</sup> might be beneficial to state courts in managing complex litigation. The Mississippi Judicial Advisory Study Committee's meeting on September 24, 1993, concluded by noting that one of the areas of immediate need to enable state trial judges to cope with mass litigation is additional staff.<sup>159</sup> It is suggested that Rule 53 should be amended either to liberalize the qualifications of those serving as masters, or to provide an exception for complex/mass tort cases. It might be that the authority to approve a master for work with such cases should be given to the Chief Justice of the Mississippi Supreme Court, who can work closely with the Administrative Office of Courts.<sup>160</sup>

---

<sup>154</sup> FED. R. CIV. P. 53(a) states: "MASTERS. (a) APPOINTMENT AND COMPENSATION. The court in which any action is pending may appoint a special master therein. As used in these rules the word 'master' includes a referee, an auditor, an examiner, and an assessor."

<sup>155</sup> See Hazard & Rice, *supra* note 147.

<sup>156</sup> FED. R. CIV. P. 53(b); MISS. R. CIV. P. 53(c).

<sup>157</sup> For an analysis of the potential costs and benefits of referring discovery matters to a special master, see BRAZIL ET AL., *supra* note 146, at 25-34.

<sup>158</sup> See *supra* note 153 and accompanying text.

<sup>159</sup> MINUTES, *supra* note 4, at 3-4.

<sup>160</sup> For a discussion of the Administrative Office of Courts, see *supra* notes 1-3 and accompanying text.

## V. CONCLUSION

The federal experience in management of complex cases over the past fifty years illustrates the difficulties Mississippi should expect as it wades into the complex litigation/mass tort fray. Complex cases are clearly on the rise in the state, paralleling the rise nationally, and it seems clear that procedural "quick fixes" alone are an inadequate response to such an enormous and growing problem. However, the authors believe that certain procedural devices for case management and coordination, including relaxed venue/court transfer provisions, the use of special masters, and a procedure for establishment of class actions deserve further study by the state bar and judiciary. Hopefully, this article will provide a starting point for a comprehensive study by appropriate representatives of those groups already feeling the profound impact of the new types of mass litigation.

# OF BATs, BIRDS AND B-A-T: THE CONVERGENT EVOLUTION OF ENVIRONMENTAL LAW

*Oliver A. Houck\**

## I. INTRODUCTION

We live in a riot of environmental legislation. No other field of law has grown into so much from so little in so short a time. Twenty years ago, about the lifetime of a young law student, the first new federal environmental programs were barely crawling out of their caves. Single-paragraph statutes for the management of forests, mining, grazing and water resources, laws dating back to the 1800s, lay dormant as fossils. Today, eyeing the tangle of statutes, regulations and court decisions that surround every aspect of development from location to production to liability for years beyond closure, statutes written at book length and in mind-numbing detail, accreted in layers of amendments, studded with acronyms so frequent as to resemble a foreign language, operating in tandem and even at cross-purposes with other statutes, the question arises: why is there so much of this stuff and why is it so hard?<sup>1</sup>

---

\* *Professor of Law, Tulane University.*

<sup>1</sup> In a recent article proposing "a fresh start" for environmental law, Charles Alpert, a consultant with more than 20 years of experience in the field, observes:

Today, the tax code seems like easy reading compared to the environmental code. At the time of the first Earth Day in April 1970, the country had about 2,000 federal, state, and local environmental laws and regulations. Today that number has grown to about 100,000. One consulting company estimates that we can expect to see 90,000 rule changes during the next four years.

*A Fresh Start for Environmental Regulation*, [Current Developments] Env't Rep. (BNA) No. 21, at 923 (Sept. 24, 1993). As for the difficulty of this material, former EPA



One answer is that law is a living thing and this is the way living things evolve. In his recently-published "The Diversity of Life," zoologist E.O. Wilson describes the eruption of a volcano in 1883 that obliterated all life on the island of Krakatau in the Indonesian archipelago.<sup>2</sup> The island was suddenly a empty stage. Within months, its reoccupation began. The next decades saw a surge of immigration by plants, insects, worms, crustaceans and birds, followed by larger trees and mammals, new species arriving, new and old species competing, perishing and modifying their behavior to survive in a free-for-all of growth and experimentation. One hundred years later, the re-colonization of Krakatau is not complete but the process has stabilized. The stage is now occupied by a relatively constant number of forms that resemble life elsewhere and which make their livings doing similar things.<sup>3</sup>

In 1970, environmental law arrived in the United States with similar suddenness on a nearly empty stage. It did not sneak in the rear entrance. It was rushed to the footlights in response to first-ever and highly-publicized oil spills and smog inversions, brownouts and fish kills, rivers that caught fire, urban communities bulldozed for highways, the Everglades designated for a jetport, Memphis' Overton Park transformed into an interstate, evidence linking pesticides with cancer and the chilling predictions of a *Silent Spring*.<sup>4</sup> We perceived environmental crises and the one thing that this great array of problems had in common, an array that would only be augmented with new disclosures on the effects of leaded gasoline, PCBs, and what lay underground at Love Canal and The Valley of the

---

Administrator William Ruckelshaus has remarked that, during his tenure with the Agency, "we had only two people who understood the Clean Air Act and I wouldn't let them get into the elevator at the same time." Remarks of William Ruckelshaus to the ALI-ABA course of study in environmental law in Washington, D.C. (Feb. 1989).

<sup>2</sup> EDWARD O. WILSON, *THE DIVERSITY OF LIFE* 16-23 (1992).

<sup>3</sup> *Id.*

<sup>4</sup> RACHEL L. CARSON, *SILENT SPRING* (1962). In April 1970, public outcry culminated in the event of "Earth Day." BARRY COMMONER, *THE CLOSING CIRCLE* 5-11 (1971).

Drums, was that, as a nation, we were essentially defenseless.<sup>5</sup> There was nothing like FTSCA, FIFRA, RCRA, CERCLA, SDWA, OPA, NEPA, NFMA, FLPMA, SMCRA, CZMA, ESA, MMPA, EPCRTKA or even the Clean Water or Clean Air Acts as we know them today.<sup>6</sup> The stage was set for an evolutionary explosion.

---

<sup>5</sup> See S. REP. NO. 296, 91st Cong., 1st Sess. 4 (1969). Senate Report 296 of the National Environmental Policy Act of 1969 begins:

It is the unanimous view of the members of the Interior and Insular Affairs Committee that our Nation's present state of knowledge, our established public policies, and our existing governmental institutions are not adequate to deal with the growing environmental problems and crises the Nation faces.

The inadequacy of present knowledge, policies, and institutions is reflected in our Nation's history, in our national attitudes, and in our contemporary life. We see increasing evidence of this inadequacy all around us: haphazard urban and suburban growth; crowding congestion, and conditions within our central cities which result in civil unrest and detract from man's social and psychological well-being; the loss of valuable open spaces; inconsistent and, often incoherent rural and urban land-use policies; critical air and water pollution problems diminishing recreational opportunity; continuing soil erosion; the degradation of unique ecosystems; poor architectural design and ugliness in public and private structures; rising levels of noise; the continued proliferation of pesticides and chemicals without adequate consideration of the consequences; radiation hazards; thermal pollution; an increasingly ugly landscape cluttered with billboards, power lines, and junk yards; and many, many other environmental quality problems.

*Id.*

<sup>6</sup> See Toxic Substances Control Act (FTSCA), 15 U.S.C.A. §§ 2601-2692 (West 1982 & Supp. 1993); Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), 7 U.S.C.A. §§ 136a-4 (West 1980 & Supp. 1993); Resources Conservation & Recovery Act of 1976 (RCRA), 42 U.S.C.A. §§ 6901-6992k (West 1983 & Supp. 1993); Comprehensive Environmental Response Compensation & Liability Act of 1980 (CERCLA), 42 U.S.C.A. §§ 9601-9675 (West 1983 & Supp. 1993); Safe Drinking Water Act (SDWA), 42 U.S.C.A. §§ 300g-1 to 300j-26 (West 1991); Oil Pollution Act of 1990 (OPA), 33 U.S.C.A. §§ 2701-2761 (West 1986 & Supp. 1993); National Forest Management Act of 1976 (NFMA), 16 U.S.C.A. § 1604(c) (West 1985); Federal Land Policy & Management Act of 1977 (SMCRA), 30 U.S.C.A. §§ 1201-1328 (West 1986 & Supp. 1993); Endangered Species Act (ESA), 16 U.S.C.A. § 1531-1544 (West 1986 & Supp. 1988); Marine Mammal Protection Act of 1972 (MMPA), 16 U.S.C.A. §§ 1361-1421h (West 1985 & Supp. 1993); Emergency Planning & Community Right-to-Know Act of 1986 (EPCRTKA), 42 U.S.C.A. §§ 11001-11050 (West 1988 & Supp. 1993); Clean Water Act [hereinafter CWA], 33 U.S.C.A. §§ 1251-1387 (West 1986 & Supp. 1993); Clean Air Act [hereinafter CAA], 42 U.S.C.A. §§ 7401-7671g (West 1983 & Supp. 1993).

Twenty years later, the explosion continues. In Fall 1993 alone, having just completed an exhaustive overhaul of the Clean Air Act (CAA),<sup>7</sup> the United States Congress is revisiting and revising the Clean Water Act (CWA), the Endangered Species Act (ESA) and Resources Conservation and Recovery Act of 1976 (RCRA). In these revisions, like Fibber McGee's closet, nothing gets thrown away. New provisions are piled on top of old provisions that go on to eke out perfunctory half-lives on the margins of the law. Unheralded provisions of original statutes grow to become their predominant features and success; Superfund has cleaned up relatively few of the abandoned sites it was intended to remedy, and at frightening costs,<sup>8</sup> but its brief liability provisions have worked wonders to deter the creation of new hazardous waste problems in the future.<sup>9</sup> At times Congress leads, at times it follows the initiatives of agencies trying to work their way out of a jam,<sup>10</sup> at times it codifies compromises arrived at in litigation,<sup>11</sup> and

---

<sup>7</sup> 42 U.S.C.A. §§ 7401-7671g. These amendments were nearly a decade in the making and required presidential intervention to break the logjam of opposing interests. See *Letter from President Bush to House, Senate Conferees and Administration Proposal to Break Clean Air Act Deadlock*, [Current Developments] Env't Rep. (BNA) No. 22, at 1106-09 (Sept. 28, 1990); see also Alyson Pytte, *A Decade's Acrimony Lifted in the Glow of Clean Air*, CONG. Q. WKLY. REP., Oct. 27, 1990, at 3587-92.

<sup>8</sup> *Cost of Waste Cleanups Underestimated, Especially if Federally Funded, Study Finds*, [Current Developments] Env't Rep. (BNA) No. 31, at 1485-86 (Nov. 30, 1990); *Letter Re Hazardous Waste Sites*, 246 SCIENCE 1097 (1989); see Rena Steinzor, *Until EPA Cleans Up Its Act, Superfund a Super Cash Drain*, LEGAL TIMES, Apr. 8, 1988, at 17-18.

<sup>9</sup> *National Effort Underway to Develop Standards for Due Diligence in Commercial Transactions*, [June-May] Toxics L. Rep. (BNA) No. 2, at 78-83 (June 13, 1990); see *The Fleet Factors' Decision: Its Effect on Secured Lending*, [June-May] Toxics L. Rep. (BNA) No. 1, at 23-26 (June 6, 1990); *The Aceto Case: CERCLA Liability for Products?*, [Current Developments] Env't Rep. (BNA) No. 16, at 704-06 (Aug. 18, 1989).

<sup>10</sup> See 42 U.S.C.A. § 7401-7671g (amendments correspond with EPA's early initiatives to allow for new industry growth in non-attainment areas through "offsets" from other polluting sources); see also 33 U.S.C.A. § 1317(c) (amendments ratified EPA's whole toxicity testing program). See generally FREDERICK R. ANDERSON ET AL., ENVIRONMENTAL PROTECTION: LAW & POLICY 230 (1st ed. 1984).

<sup>11</sup> See 33 U.S.C.A. § 1317(a)(1) (codifying settlement in *Natural Resources Defense Council, Inc. v. Train*, 6 Env'tl. L. Rep. (Env'tl. L. Inst.), at 20,588 (D.D.C. June 9, 1976). See generally Ridgeway M. Hall, *The Evolution & Implementation of EPA's Program to Control the Discharge of Toxic Pollutants to the Nation's Waters*, 10, NAT. RESOURCES



at times it is forced to address issues surfaced by litigation<sup>12</sup> and by accident and design, trial and error, the great experiment goes forward.

Twenty years later, however, is also sufficient time to see a pattern in environmental law. Despite the high rate of flux, we can reach preliminary conclusions as to which approaches succeed and which do not. It is the thesis of this article that much of environmental law has converged around one approach, and that the success of this approach is in fact demonstrated by its imitation and use. This, too, is nature at work. If creatures of greatly different origins, such as bats, birds and insects, need to perform a certain function, such as catching small insects on the fly, over time they will develop similar mechanisms, such as wings. The phenomenon is called convergent evolution, and it has been demonstrated in micro-environments and on the scale of continents where the niche of a predator may, in North America, be filled by long-toothed cats and in South America, by flightless, long-beaked birds.<sup>13</sup> Over time, the job will select the tool.

So it is with the evolving organism of environmental law. Contrary to the original expectations of these many laws, and in contrast to their efforts to scale human activities to effects on human health and the environment, this article proposes that the dominant tool of successful environmental law, be it law to abate pollution or to manage natural resources, is the examination of alternatives. The more serious we are about protecting the environment, the more our laws rely on compelling alternative courses of action.

---

L. 507 (1977).

<sup>12</sup> See Endangered Species Act [hereinafter ESA], 16 U.S.C.A. §§ 1531-1544 (West 1985 & Supp. 1993) (amendments to ESA providing for exemption process for federal projects jeopardizing species prompted by *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978)); see also National Forest Management Act [hereinafter NFMA], 16 U.S.C.A. § 1604(c) (West 1985 & Supp. 1993) (prohibiting clear-cutting in national forests prompted by *West Virginia Division of Izaak Walton League of America v. Butz*, 522 F.2d 945 (4th Cir. 1975)).

<sup>13</sup> WILSON, *supra* note 2, at 16-23.

## II. POLLUTION CONTROL AND ALTERNATIVE-BASED STANDARDS

Pollution control matters. One third of the people of the state of Louisiana, in which this author resides, live along the Mississippi River and, among other things, take their drinking water from it.<sup>14</sup> Upstream from the City of New Orleans, nearly two hundred major industrial and municipal facilities discharge directly into the River, forty-five of them among the largest petro-chemical facilities in the world.<sup>15</sup> The toxic discharges from just two of these chemical plants exceed all the discharges from all industries located in the state of Ohio;<sup>16</sup> emissions from one Louisiana plant alone exceed the total emissions from all industries located in the state of New Jersey.<sup>17</sup> We discharge, and thus receive, 427 million pounds of toxins a year in Louisiana, making this relatively small state the nation's number one polluter in water and number two, second only to Texas, in air.<sup>18</sup> These data differ from other

---

<sup>14</sup> P. COSTNER & J. THORTON, *WE ALL LIVE DOWNSTREAM: THE MISSISSIPPI RIVER AND NATIONAL TOXICS CRISIS* 93 (1989).

<sup>15</sup> P. Romanowsky, Louisiana Department Environmental Quality, Water Pollution Control Division, Progress in the Development of Louisiana's Lower Mississippi River Water Quality Management Program 2 (1984) (unpublished manuscript on file with author at Tulane School of Law) (from St. Francisville to Venice, there are more than 350 companies along the Mississippi River and 175 of those discharge chemical wastes directly into the Mississippi) cited in Oliver A. Houck, *This Side of Heresy: Conditioning Louisiana's Ten Year Industrial Tax Exemption Upon Compliance with Environmental Laws*, 61 TUL. L. REV. 289, 312 ns.9, 128 (1986); see also COSTNER & THORNTON, *supra* note 14, at 91 (noting that 150 mile stretch of Mississippi River between Baton Rouge and New Orleans hosts at least 136 major industrial dischargers); Telephone Interview with Al Hindrichs, Louisiana Department of Environmental Quality (Oct. 8, 1993) (stating 49 sewage plants and landfills in 53 municipalities complete balance).

<sup>16</sup> Mark Schleifstein, *Louisiana Leads U.S. in Toxins*, TIMES-PICAYUNE, May 28, 1992, at A1. Ohio is the fifth largest toxic discharger in the U.S. (168 million pounds) which is outweighed by American Cyanamid (162 million pounds) and Freeport McMoRan Corp.-Agrico Division, St. James (56.5 million pounds). *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* Louisiana discharges 12% of the nation's 3.6 billion pounds toxic chemicals according to the Toxic Release Inventory. *Id.*; see also *Louisiana to Top EPA List of Worst Polluters*, TIMES-PICAYUNE, May 25, 1992, at B5 (citing air emissions at 105.6 million pounds for Louisiana vs. 165 million pounds for Texas). In addition, in 1992, one of the largest dischargers, and discharge permit violators, in the state of Texas,

regions of the country only in degree. The rivers of the Pacific Northwest,<sup>19</sup> the Great Lakes<sup>20</sup> and cities the size of Cleveland<sup>21</sup> have their own tales to tell, as do more than one hundred American cities with air quality officially designated as dangerous to human health.<sup>22</sup> The environmental law question is, of course, how does any pollution control program come to grips with discharges on this scale?

The answer for Louisiana and the nation has been: slowly and through experimentation. The history of water pollution control provides an illustration, although a similar outline could be provided for air or waste. The government started all of these programs in the same fashion, quite indirectly, as efforts

---

Formosa Plastics, announced that it would open a new plant on the Mississippi River. Christina Cheakalos, *The Battle for "Cancer Alley": A Thin Green Line Louisiana Town Fights a Chemical Giant*, THE ATLANTA CONSTITUTION, Feb. 23, 1992, at B4; see also *Atochem Pays \$900,000 Fine for Pollution Violations*, HOUSTON POST, Aug. 20, 1992, at A31. Later that same year, a Canadian company with the unsettling name of Tioxide, facing a closure order and \$36 million in fines from the Canadian government announced that it, too, was moving to Louisiana. *Sears Tops Layoffs*, HOUSTON POST, Feb. 2, 1993, at C4.

<sup>19</sup> *Water Pollution Dioxin Danger in Columbia River Fish Discounted in Study Done by Paper Industry*, [Current Developments] Env't Rep. (BNA) No. 35, at 1446-47 (Dec. 29, 1989). See generally *Water Pollution: EPA Criticized for Not Reporting Sampling Information on Dioxin in Fish*, [Current Developments] Env't Rep. (BNA) No. 20, at 1430 (Dec. 22, 1989); *Litigation: Citizen Groups Sue EPA Over Strategies to Control Dioxin Discharges in Washington*, [Current Developments] Env't Rep. (BNA) No. 21, at 1559 (Dec. 14, 1990).

<sup>20</sup> *Epidemic of Cancer in Fish Cited as Indicator of Human Health Concerns*, [Current Developments] Env't Rep. (BNA) No. 14, at 906 (Sept. 23, 1983) (citing Rep. John Breau). The EPA uses a fish consumption rate of 6.5 grams of fish per day per person to set water quality standards. NATIONAL WILDLIFE FED. AND THE CANADIAN INST. FOR ENVTL. LAW AND POLICY, A PRESCRIPTION FOR HEALTHY GREAT LAKES: REPORT OF THE PROGRAM FOR ZERO DISCHARGE 40-41 (1991). However, a survey revealed that 5% of Wisconsin residents eat 63.4 grams or more each day; therefore, for the Great Lakes Basin, the NWF recommended using a fish consumption rate of 50 grams per day. *Id.*

<sup>21</sup> Patricia Howard, *A Happier Cleveland*, HOUSTON POST, Oct. 24, 1990, at A2 (recounting fire on Cuyahoga River in Cleveland, Ohio in 1969).

<sup>22</sup> As of 1988, 101 urban areas were designated non-attainment for ozone and 52 for carbon monoxide. H.R. REP. No. 490, 101st Cong., 2d Sess., pt. 1, at 196, 204-05 (1990).



to assist the states with federal monies.<sup>23</sup> Some states in fact did make early progress, particularly those along the northern tier. In the South, however, pollution requirements imposed by other states presented an irresistible opportunity to bid for new industry with low requirements, or none at all. Alabama's Governor George Wallace was not alone in standing, arms open like a Statute of Liberty — send us your polluters, we'll take 'em.<sup>24</sup>

The specter of states bargaining for industrial development by trading off environmental quality prompted the federal government to seek some consistency in pollution control through national standards.<sup>25</sup> The question became one of

---

<sup>23</sup> See generally 2 WILLIAM H. ROGERS, JR., ENVIRONMENTAL LAW §§ 4.16-4.19 (1986) (overviewing federal involvement in regulation of air, water and waste).

<sup>24</sup> David Olinger, *Alabama Grows Wary of Serving as National Toxic Waste Burial Site*, ST. PETERSBURG TIMES, July 15, 1990, at 1D (Governor Wallace's encouragement of business at expense of environment); see Thomas Petzinger, Jr. & George Getschow, *Oil's Legacy: In Louisiana, Big Oil is Cozy with Officials & Benefit is Mutual*, WALL ST. J., Oct. 22, 1984, at 1 (Louisiana's similar encouragement of oil and gas and petrochemical industries).

<sup>25</sup> See H. R. REP. No. 911, 92d Cong., 2d Sess., pt. 2, at 396 (1972). Representative Vanik [D-Ohio] commented: "[D]ue to the pressures of powerful economic interests, the States do not establish meaningful quality levels and create water 'zones' — some good, but mostly bad." *Id.* at 494. Another Representative from Massachusetts stated:

One of the most critical problems inherent in legislating water pollution controls is that the standards will be so haphazard that workers will be pushed out of jobs by industries moving from State to State in search of less strict pollution standards . . . . We must establish national effluent limitations to prevent industrial "shopping" and we must establish an equitable system of assistance to those workers and communities affected by plant closures due to environmental regulations.

*Id.* at 517, Rep. Harrington [D-Mass.].

For the early developments of water quality standards requirements, see Water Pollution Control Act, Pub. L. No. 80-845, 62 Stat. 1155 (codified as amended in scattered sections of 33 U.S.C.A.) (1948); Water Pollution Control Act Amendments of 1956, Pub. L. No. 84-660, 70 Stat. 498 (codified as amended in scattered sections of 33 U.S.C.A.); Federal Water Pollution Control Act Amendments of 1961, Pub. L. No. 87-88, 75 Stat. 204 (codified as amended in scattered sections of 33 U.S.C.A.); and Water Quality Act of 1965, Pub. L. No. 89-234, 79 Stat. 903 (codified as amended in scattered sections of 33 U.S.C.A.) (codifying early developments of water quality standard requirements); see Air Pollution Control Act of 1955, Pub. L. No. 84-159, 69 Stat. 322 (codified as amended in scattered sections of 42 U.S.C.A.); The Motor Vehicle Act of 1960, Pub. L. No. 86-493, 74 Stat. 162; Clean Air Act of 1963 (codified as amended in scattered sections of 42 U.S.C.A.), 77 Stat. 392; Motor Vehicle Pollution Control Act of

what to base those standards on, and the answer seemed logical enough. They would be based on thresholds of pollution above which it caused biological harm. The federal government would provide numbers for acceptable levels of pollution in the water, called "ambient-based" standards. When waters became unacceptable, the parties responsible would be required to clean up their emissions.<sup>26</sup> As any student of history knows, for all of its logic, this approach failed utterly.<sup>27</sup> Science could not tell us with mathematical certainty what thresholds were safe, even for aquatic organisms; there were too many organisms out there, under too many conditions.<sup>28</sup> Science could hardly identify for us all of the relevant pollutants when it was also discovering and manufacturing new compounds every month. It was similarly difficult for science to determine the combined effects of these compounds as they mixed like cocktails in the receiving waters, to say nothing of identifying acceptable levels for reproductive, sublethal and long-term effects.<sup>29</sup> Nor were

---

1965, Pub. L. No. 89-272, 79 Stat. 992; Air Quality Act of 1967, Pub. L. No. 90-148, 81 Stat. 485 (ratifying early developments of air standards).

<sup>26</sup> See ROGERS, *supra* note 23, at 284-85; *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1019-20 (D.C. Cir. 1978) (stating ambient standard approach not viable).

<sup>27</sup> *Weyerhaeuser Co.*, 590 F.2d at 1019-20. See generally ANDERSON ET AL., *supra* note 10, at 130-31.

<sup>28</sup> See, e.g., statements of Sen. Baker [R-Tenn.]: "[W]e are recognizing for the first time that there is not a readily definable linear relationship between given effluent discharges and the quality of the receiving waters." 117 CONG. REC. 38,809 (1971); and those of Reps. Abzug [D-N.Y.] and Rangel [D-N.Y.]: "We have seen a great deal of evidence indicating that this water quality standards system of regulation assumes more knowledge about our complex ecosystem than we actually have. The numerical criteria themselves are often largely arbitrary . . ." H. R. REP. No. 911, 92d Cong., 2d Sess., pt.2, at 396 (1972). Even today, toxic levels for individual compounds are in great dispute. See EPA, WATER POLICY REP. 7-29 (Feb. 3, 1993).

<sup>29</sup> See, e.g., EPA, QUALITY CRITERIA FOR WATER 116-19, t. 10 (1976) (the "Red Book"). The most striking aspect of many criteria is the uneven quantity and inconclusive quality of the studies cited. *Id.* (comparing criterion and rationale for malathion, studies of effects on rainbow trout, bluegill, fathead minnows, shrimp, and oysters, with criteria for vinyl chloride where no tests have been made on freshwater or saltwater organisms and "no statement can be made concerning acute or chronic toxicity"). These criteria are of course only summaries of existing research, but they reflect the most current and relevant information available. *Id.* at 38, rationale for chromium ("[K]nowledge of the harmful human health effects of hexavalent chromium has been obtained almost entirely from occupational health effects"). But see QUALITY

we able to determine what levels of these pollutants actually exist out there on a daily basis in each of our tens of thousands of rivers, lakes and estuaries.<sup>30</sup> Even today, after nearly thirty years of effort on this approach to water pollution control, fewer than half the waters of this country are monitored for even the crudest pollutants, and then as infrequently as once a month.<sup>31</sup> It should be no surprise, therefore, that we discover water quality problems only when fish begin to die and frogs and

---

CRITERIA FOR WATER, *supra* at App. B (criteria based mostly on consumption of contaminated water and aquatic organisms assumed to have bioconcentrated pollutants from water — for vast majority of pollutants, other sources of exposure, such as air, nonaquatic diet, and dermal, were not used due to lack of data).

<sup>30</sup> EPA, NATIONAL WATER QUALITY INVENTORY: 1986 REPORT TO CONGRESS 71 (identifying "monitoring" as "continuing special need"), cited in Oliver A. Houck, *The Regulation of Toxic Pollutants Under the Clean Water Act*, 21 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 10,528, 10,530 n.18 (1991) [hereinafter *The Regulation of Toxic Pollutants*]; see EPA, NATIONAL WATER QUALITY INVENTORY: 1990 REPORT TO CONGRESS, xxiv; EPA, ASSESSMENT OF STATE NEEDS FOR TECHNICAL ASSISTANCE IN NPDES PERMITTING, III-11, 12 (1984). Congress has long recognized the "monitoring gap" in water quality standard-based programs, particularly for toxic pollutants:

As Congress recognized in enacting the Clean Water Act of 1977, the state-of-the-art ability to monitor and detect toxic pollutants is limited. Most of the toxic pollutants were relatively unknown until only a few years ago, and only on rare occasions has EPA regulated, or has industry monitored or even developed methods to monitor for these pollutants . . . Moreover, state-of-the-art techniques involve the use of expensive, sophisticated equipment, with costs ranging as high as \$200,000 per unit.

44 *Fed. Reg.* 62,204, 62,208 (Oct. 29, 1979). The problem continues in 1991. *Federal Monitoring Beset by Gaps, Duplication Despite Large Expenditures, State Official Says*, [Current Developments] *Env't Rep. (BNA)*, No. 21, at 113 (May 17, 1991) (stating federal water quality monitoring plagued by gaps); see also *GAO Tells House Panel Most U.S. Waters Not Monitored or Assessed, Faults EPA, States*, [Current Developments] *Env't Rep. (BNA)*, No. 22, at 82 (Aug. 2, 1992). In 1993:

EPA scientists and officials together with outside scientists have confirmed that much of the data collected for the past 20 years on impaired water bodies is seriously flawed, prompting industry attorneys and consultants to suggest that hundreds — and possibly thousands — of dischargers may have been inaccurately accused of violating Clean Water Act standards.

WATER POLICY REP., *supra* note 29, at 3.

<sup>31</sup> *Congress Lacks Conclusive Data Needed to Assess Water Act, Hydrologist Says*, [Current Developments] *Env't Rep. (BNA)*, No. 53, at 3235 (Apr. 30, 1993) (stating lack of conclusive data impedes congressional efforts to evaluate water quality).



amphibians are disappearing world-wide; we do not have a clue.<sup>32</sup> Even when we can identify the culprit as a particular pollutant, it is still difficult to assign the responsibility for abating it. This is the age-old problem of "causation," and in all but the most limited water body, there are multiple causes of pollution, man-made and natural, which provide unlimited opportunities to assign the blame to others.<sup>33</sup> The early ambient-based pollution control programs produced endless rounds of finger-pointing and little cleanup.<sup>34</sup>

Propelled by new data on the health effects of pollution, the late 1970's saw the emphasis in federal programs shift away from general biological standards and towards toxicological impacts on human beings themselves. Not only the Clean Air<sup>35</sup> and Clean Water<sup>36</sup> Acts of the time, but also new laws regulating pesticides,<sup>37</sup> hazardous wastes,<sup>38</sup> and the introduction of new toxic substances into commerce,<sup>39</sup> required a determination that there would be no unreasonable risk to health and safety. These laws led the charge into "risk assessment" and "risk management," that continues today<sup>40</sup>

---

<sup>32</sup> Berkley Hudson, *Where Have All the Frogs Gone?*, L.A. TIMES, Aug. 30, 1993, at B1.

<sup>33</sup> This difficulty in accurately pinpointing blame or causation led to the demise of the use of common law principles to abate water pollution and gave rise to regulatory programs; no one could prove who did it. See generally ANDERSON ET AL., *supra* note 10, at 51-58.

<sup>34</sup> See, e.g., ROGERS, *supra* note 23, at 281.

<sup>35</sup> 42 U.S.C.A. §§ 7409, 7412; see also, *Weyerhaeuser Co.*, 590 F.2d at 1019-20 (discussing statutory framework of water quality standards).

<sup>36</sup> 33 U.S.C.A. § 1317(a). The Act directs the administration to publish a "list" of toxic pollutants. *Id.* § 1317(a)(1). The Act also recommends proposed "effluent standard (or prohibition) [for such pollutants which] shall take into account the toxicity of the pollutant, its persistence, degradability, the usual or potential presence of the affected organisms . . . and the nature and extent of the toxic pollutant on such organisms . . . ." *Id.* § 1317(a)(2).

<sup>37</sup> FIFRA §§ 3-6, 7 U.S.C.A. §§ 136(a)-(d).

<sup>38</sup> RCRA §§ 3004(u)-(v), 7003, 42 U.S.C.A. §§ 6924(u)-(v), 6973.

<sup>39</sup> FFTSCA §§ 2-4, 15 U.S.C.A. § 2691 (1988) (amended 1992); 15 U.S.C.A. §§ 2602-2603.

<sup>40</sup> See generally JOHN J. COHRSEN & VINCENT T. COVELLO, *EPA RISK ANALYSIS: A GUIDE TO PRINCIPLES & METHODS FOR ANALYZING HEALTH & ENVIRONMENTAL RISKS* (1989); see also BARRY COMMONER, *MAKING PEACE WITH THE PLANET* 56-78 (1990); ROBERT V. PERCIVAL, *ENVIRONMENTAL REGULATIONS & LAW, SCIENCE, AND POLICY* 440,

with strong support from laboratories and researchers who engage in it.<sup>41</sup> These laws also require, however, far more specificity from science than it is able to deliver.<sup>42</sup> We no more easily identify arithmetic thresholds for human health than we do for aquatic life. Many carcinogens, for example, have no known thresholds; they are carcinogenic in any amount.<sup>43</sup>

---

611-12 (1990); U.S. GEN. ACCOUNTING OFFICE, TOXIC SUBSTANCES: EFFECTIVENESS OF UNREASONABLE RISK STANDARDS UNCLEAR 3 (July 1990) (pointing out difficulty in determining if unreasonable risk standard was primary reason for few number of regulations); John S. Applegate, *The Perils of Unreasonable Risk: Information Relating Policy, and Toxic Substance Control*, 91 COLUM. L. REV. 261, 261 (1991) (stating that EPA must analyze information about activities it wishes to regulate and available control techniques before addressing statutory trade-offs between safety and costs); David D. Doniger, *Federal Regulation of Vinyl Chloride: A Short Course in the Law and Policy of Toxic Substance Control*, 7 ECOLOGY L.Q. 500, 501 (1978) (recognizing that law and policy in area of toxic substance control are in rapid growth and transition still lacking organization); Talbot Page, *A Generic View of Toxic Chemicals and Similar Risks*, 7 ECOLOGY L.Q. 207, 208-14 (1978) (listing nine characteristics of environmental risk problems); William D. Ruckelshaus, *Risk in a Free Society*, 15 ENVT'L. L. Rep. (Env'tl. L. Inst.), at 10,190, (May 1984) (defining differences between risk assessment and risk management and EPA proposals on how both should be handled).

<sup>41</sup> John Pope, *Environmental Research Is On*, TIMES-PICAYUNE, Mar. 31, 1994, at A1, A3 (dedication of new \$35 million research complex to study environmental risks and risk assessments). The widespread popularity of risk assessment has produced the Society of Risk Assessment and several conferences. *Id.*; see, e.g., Continuing Education Program, *New Methods of Risk Assessment*, AMERICAN COLLEGE OF TOXICOLOGY, New Orleans, La. (Oct. 3, 1993); Conference, *Society of Environmental Geochemistry & Health on Risk Assessment*, TULANE MED. CENTER (July 1993); see also *Support for Risk Assessment*, [Current Developments] Env't Rep. (BNA) No. 18, at 2012 (Jan. 15, 1988) (stating that risk assessment is essential for EPA to identify those substances that pose most risk); Conference, *Understanding the Scientific Principles Behind Environmental Regulation: The Scientific and Technical Survival Course for Lawyers and Managers*, EXECUTIVE ENTERPRISES, Washington, D.C. and San Francisco, CA (Jan.-Feb. 1991).

<sup>42</sup> See Guidelines for Carcinogen Risk Assessment, 51 Fed. Reg. 33,992, 33,994 (1986) (indicating that there are many questions encountered in risk assessment process that are unanswerable given current scientific knowledge).

<sup>43</sup> Doniger, *supra* note 40, at 510; Page, *supra* note 40, at 222; Ruckelshaus, *supra* note 40, at 10, 190. Scientists are still trying to establish the relationship between breast cancer and some of the best studied pesticides. Rita Beamish, *Pesticide-Breast Cancer Link to Be Investigated*, TIMES-PICAYUNE, Oct. 22, 1993, at A8. For another contemporary illustration of this uncertainty, see *Epidemiological Data on Dioxin Risk*, [Current Developments] Env't Rep. (BNA) No. 24, at 890 (Sept. 17, 1993) (stating epidemiological studies indicate increased incidence of cancer among humans exposed to dioxin, *five of eight scientists agreed*) (emphasis supplied); see also Paul Raeburn, *Study Links DDT to Breast Cancer*, TIMES-PICAYUNE, Apr. 21, 1993, at A3.

Deriving standards for these and other toxins often involves more guesswork than a television game show. Lacking direct information on human impacts, and unable to use human beings as guinea pigs (at least not overtly),<sup>44</sup> we have relied on laboratory experiments with hundreds of thousands of mice. These "mega-mouse" experiments, from which we project impacts on human beings through unproven dose-response relationships, extrapolations from small bodies to large bodies, "safety factors" for lethal and sublethal effects that are often no more sophisticated than dividing a lethal dose by ten, speculation over exposure pathways, over hypothetical individuals breathing one thousand feet from the emissions pipes, or eating quantities of contaminated dirt, for interrupted or uninterrupted lifetimes, by particularly sensitive individuals, the young, the old, the sick,<sup>45</sup> all to determine something called "risk," reduced to a beguiling, scientific-appearing, mathematical equation: a discharge concentration of X parts per million will lead to one death in ten thousand people.<sup>46</sup>

Even these uncertainties pale, however, against the subsequent determination of "unreasonable" risk, the so-called

---

<sup>44</sup> Michaud, *Three Plant Areas Under Federal Study*, SUNDAY ADVOC., Feb. 18, 1979, at A1 (quoting Eugene Sawacki, Analytical chemist with EPA). In the words of an EPA official:

You almost don't need test animals in a way. We have . . . plenty of people breathing in these chemicals in the Baton Rouge area. All we have to do is keep an eye on them and keep good statistics.

It's human experimentation going on . . . all we can do right now is collect statistics from our human guinea pigs so to speak, then wait and see.

*Id.*

<sup>45</sup> Guidelines for Carcinogen Risk Assessment, 51 Fed. Reg. at 33,998-99; see *Hercules v. EPA*, 598 F.2d 91, 103 (D.C. Cir. 1978) (giving illustrations of entire conferences and continuing education courses are devoted to plumbing the depths of risk-benefit analysis). See generally Risk Management and System Safety Practice for Occupational Safety and Health Professionals, Address Before the Continuing Education Seminar, University of Cincinnati Department of Environmental Health 1992-1993; (plumbing depths of risk-benefit); Doniger, *supra* note 40, at 12.

<sup>46</sup> See generally 53 Fed. Reg. 28,496 (1988) (to be codified at 40 C.F.R. pt. 6) (proposed July 28, 1988) (showing development of toxic air quality standards for benzene).



"risk management" decision.<sup>47</sup> Would Oxford, Mississippi accept a hazardous waste incinerator at a projection of one in ten thousand deaths? If the incinerator were to employ 100 currently-unemployed people, would the outcome change? Are new jobs, or increased costs, relevant factors in a decision on how many people should die?<sup>48</sup> And what agency, indeed what institution of government, should make this call: the state environmental agency, the governor, the state legislature, or perhaps the citizens of Oxford?<sup>49</sup> Who would play God? The answer is that no one would; the questions are too difficult to answer. As a result, with some of the most stringent sounding laws imaginable to protect human health and the environment from toxic pollution, the EPA has added only a handful of toxic standards for water emissions,<sup>50</sup> air emissions,<sup>51</sup> pesticides<sup>52</sup> and new toxic compounds<sup>53</sup> in almost two decades. This is despite the fact that we are dealing with a known universe of

---

<sup>47</sup> "Risk management" is the determination of what level of risk is acceptable. PERCIVAL, *supra* note 40, at 440.

<sup>48</sup> See generally *Natural Resources Defense Council, Inc. v. EPA*, 824 F.2d 1146 (D.C. Cir. 1987) (stating courts cannot clearly discern congressional intent as to whether cost should be included in setting toxic emission standards).

<sup>49</sup> Former EPA Administrator Ruckelshaus has suggested in connection with a decision to permit a smelter in Tacoma, Washington, that it would be more appropriate for local people than for the EPA to determine the acceptability of the risk. See Ruckelshaus, *supra* note 40, at 10,190.

<sup>50</sup> S. REP. NO. 414, 92d Cong., 2d Sess. 2 (1972), *reprinted in* 1972 U.S.C.C.A.N. 3,668, 3,671 (discussing water pollution control standards); see S. REP. NO. 50, 99th Cong., 1st Sess. 3 (1985) (observing that regulation of toxic pollutants proceeding at slow pace).

<sup>51</sup> EPA's quandary in regulating toxics under the CAA became the subject of prolonged litigation and discussion, if only because it went for nearly 20 years without an alternative solution from the courts or from Congress. See, e.g., *Natural Resources Defense Council, Inc. v. EPA*, 695 F. Supp. 48, 56 (D.D.C. 1988) (finding that EPA has non-discretionary duty to issue final determination on whether source will be regulated); Phillip D. Reed, *The Trial of Hazardous Air Pollution Regulation*, 16 *Envtl. L. Rep. (Envtl. L. Inst.)*, 10,066 (March 1986). "In fact § 112 has proven so difficult to implement that some have written it off as unworkable." *Id.* at 10,067. At bottom were the role of costs and technology in setting an "ample margin of safety." *Id.* By 1980, EPA had listed only seven toxic air pollutants, and regulated only four; by 1984, EPA had proposed standards for only the remaining three and listed no more. *Id.* at 10,068.

<sup>52</sup> PERCIVAL, *supra* note 40, at 428.

<sup>53</sup> *Id.*

nearly 200 carcinogens, more than 60,000 toxic compounds and more combinations coming on line each year.<sup>54</sup> A mountain of labor was producing a molehill. We needed a new approach.

Water pollution control led the way. As early as the Federal Water Pollution Control Amendments of 1972, the United States adopted a great innovation in environmental law, requiring that all water discharges meet a national engineering standard, "best available technology."<sup>55</sup> This was a radical, indeed an heretical approach at the time and it remains an incitement today to those who see it as leading to "overkill" and "treatment for treatment's sake."<sup>56</sup> Indeed, the CWA requires the same degree of pollution abatement from an industry discharging into the mighty Mississippi, or into the Pacific Ocean for that matter, that it requires when the industry discharges into a tributary of the tiny Bogue Chitto.<sup>57</sup> The fact that scientists can find no "harm" to the Mississippi River or the Pacific Ocean is irrelevant. The discharge levels are simply based on the best way this industry can achieve pollution abatement, its best alternative. Since 1972, the federal government has examined these alternatives for every industrial process in the nation, negotiated them with the industries, litigated them with their trade associations, and arrived at arithmetic concentrations for the discharge of each pollutant at every outfall. These outfall concentrations are specific numbers which are recorded in individual discharge permits and are monitored by each facility and reported on a monthly basis for

---

<sup>54</sup> Frank Kover, *Information: FTSCA's Cutting Edge*, 8 EPA J. (June 1985) (referring to chemical inventory numbers since January 1, 1975, of over 52,000 chemicals); see *Less Than Half of Cancer Causing Substances Regulated by Federal Agencies, OTA Report Says*, [Current Developments] Env't Rep. (BNA) No. 18, at 1745-46 (Nov. 13, 1987).

<sup>55</sup> 33 U.S.C.A. § 1311, 1314; see *infra* note 187.

<sup>56</sup> See J. Quarles, *Cleaning Up America: An Insider's View of the Environmental Protection Agency* (1976) (describing administration efforts to amend Act); *Hearings on S. 7777 and S. 2652 Before the Subcomm. on Environmental Pollution of the Senate Comm. on Environmental and Public Works*, 95th Cong. 2d Sess. 9-10 (1982) (testimony of John Hernandez, Deputy Administrator, EPA) (zero discharge goal should not be binding).

<sup>57</sup> *Crown Simpson Pulp Co. v. Costle*, 16 Env't Rep. Cas. (BNA) 20,450 (9th Cir. 1981).

all to see and to enforce.<sup>58</sup> Did this approach require more pollution controls than are "necessary" to maintain fish populations in, for example, the Pacific Ocean? Doubtless so. Did it lead to "economic inefficiencies," where equal reductions could have been obtained by regulating some outfalls even more stringently and others less? Equally so. Also beyond cavil, however, best available technology side-stepped the age-old and irresolvable arguments of whether "significant" harm existed and who was "causing" it and began to abate the pollution itself. For the first time on a national scale, water pollution loadings began to drop.<sup>59</sup>

The federal clean air program has undergone a remarkably similar transformation. The seminal CAA of 1970 was predicated on numerical levels for air pollutants, called national ambient air quality standards, that were to be maintained by state implementation plans.<sup>60</sup> In practice, air quality standards proved every bit as uncertain and elusive as water quality standards,<sup>61</sup> and the problems of implementing them proved even more insurmountable. In the best of circumstances, the best-intentioned state program would have difficulty

---

<sup>58</sup> *Dupont v. Train*, 430 U.S. 112 (1977). See generally ROGERS, *supra* note 23, at 424-26 (stating that EPA's individual BAT decisions are promulgated in 40 C.F.R. §§ 403-699).

<sup>59</sup> See EPA WATER QUALITY IMPROVEMENT STUDY (Office of Water Regulations and Standards) (Sept. 1989) (observing that both modeling and ambient water quality monitoring showed significant re-directions in BAT-regulated pollutants following installation of BAT); see also Barry Commoner, *Failure of the Environmental Effort*, 18 *Envtl. L. Rep. (Envtl. L. Inst.)* 10,195, 10,197 (June 1988) (using Table III to show reductions from 72% to 92% for lead, DDT, PCB's, mercury, stontium 90, and phosphates); Mark Schleifstein, *Louisiana Leads U.S. in Toxins*, TIMES-PICAYUNE, May 28, 1992, at A1 (reporting that chemical releases dropped by 11% from 1989 nationwide).

<sup>60</sup> The CAA defines primary standards as "ambient air quality standards the attainment and maintenance of which in the judgment of the Administrator, based on such criteria and allowing an adequate margin of safety, are requisite to protect the public health." 42 U.S.C.A. § 7409(b)(1). The Act further states that secondary standards must "specify a level of air quality the attainment and maintenance of which in the judgment of the Administrator, based on such criteria, is requisite to protect the public welfare from any known or anticipated effects associated with the presence of such air pollutants in the ambient air." *Id.* § 7409(b)(2).

<sup>61</sup> See ANDERSON ET AL., *supra* note 10, at 174-202 (discussing development of lead standard and multiple guessing involved).



measuring what ambient air quality is like at any given time or place, to say nothing of what it was like when the wind shifted, or at night, or when the plume from distant sources begins to fall.<sup>62</sup> Engineering models of dispersion varied so widely from actual, on-scene monitoring that agencies and courts were forced to choose between them, with results that departed farther from reality.<sup>63</sup> More fatal still, in the real world state implementation programs faced outright exemptions for certain major sources<sup>64</sup> and delays in federal standards for the most major contributor of all, the automobile,<sup>65</sup> leading to plans that provided little abatement, postponed solutions, permitted anything within imagination,<sup>66</sup> and led to a steadily growing number of non-attainment areas. One leading environmental lawyer involved with the air quality standard process through-

---

<sup>62</sup> *Id.* at 154-56.

<sup>63</sup> W. David Conn, *The Difficulty of Forecasting Ambient Air Quality: A Weak Link in Pollution Control*, 41 AM. INST. PLANNERS J. 334-42 (1975); see S.R. Hayes & G.E. Moore, *Air Quality Model Performance: A Comparative Analysis of 15 Evaluation Studies*, 20 ATMOSPHERIC ENV'T 1897, 1899 (1986); Bruce M. Kramer, *Air Quality Modeling: Judicial, Legislative and Administrative Reactions*, 5 COLUM. J. ENVTL. L. 236, 246-51 (1979); see also, EPA, GUIDELINES ON AIR QUALITY MODELS (Rev. & Supp. A 1988) (discussing advanced models considered for inclusion in supplement).

<sup>64</sup> The CAA does not apply universally. Congress exempted from regulation all but "major" sources requiring prevention-of-significant-deterioration review for sources emitting 100 tons or more of designated pollutants, and a number of favored industries. See, e.g., 42 U.S.C.A. § 7412(n)(4) (oil and gas wells shall not be considered an "area source"); 42 U.S.C.A. § 7412(q)(4) (emissions from facilities licensed by the Nuclear Regulatory Commission are exempted, unless the Administrator determines that the NRC's regulatory program does not provide an ample margin of safety to protect public health). The EPA has exempted other sources by regulation. *Sierra Club v. Corsuch*, 714 F.2d 653 (D.C. Cir. 1983) (approving EPA determination to exempt surface coal mine fugitive dust from measurement of particulate matter for PSD purposes). Another loophole was provided for coal-fired power plants under EPA's original policy to allow tall stacks as a means of abating pollution, the primary effect of which was to export pollution downwind. *ANDERSON ET AL.*, *supra* note 10, at 235-36.

<sup>65</sup> See *ANDERSON ET AL.*, *supra* note 10, at 203-27.

<sup>66</sup> See *Citizens Against the Refinery's Effects, Inc. v. EPA*, 643 F.2d 183, 187 (4th Cir. 1981) (allowing offsets from oiling dust on rural roads against proposed refinery emissions); *Texas v. EPA*, 499 F.2d 289, 320 (5th Cir. 1974) (approving state implementation plan without enforcement mechanism), *cert. denied*, 427 U.S. 905 (1976).

out the 1970s has observed, in retrospect, that it was a waste of time.<sup>67</sup>

In 1977, Congress moved to strengthen the CAA with additional requirements both for regions with clean air and with unsafe levels.<sup>68</sup> Under the 1977 amendments, major sources of pollution would be required to comply with new technological standards variously termed Lowest Achievable Emissions Reduction,<sup>69</sup> Best Available Control Technology,<sup>70</sup> Reasonably Available Control Technology<sup>71</sup> and Best Available

---

<sup>67</sup> David Schoenbrod, *Goals Statutes or Rules Statutes: The Case of the Clean Air Act*, 30 UCLA L. REV. 740, 742 (1983). Mr. Schoenbrod was a senior attorney for CAA for the Natural Resource Defense Council, Inc. in the early 1970s. *Id.*

<sup>68</sup> Safe Drinking Water Amendments of 1977, 42 U.S.C.A. §§ 7401-7642 (West 1983 & Supp. 1993).

<sup>69</sup> 42 U.S.C.A. § 7503. A new or modified major stationary source in a non-attainment area must comply with the LAER (Lowest Achievable Emission Rate). *Id.* LAER is defined as "(A) the most stringent emission limitation which is contained in the implementation plan of any State for such class or category of source, unless the owner or operator of the proposed source demonstrates that such limitations are not achievable, or (B) the most stringent emission limitation which is achieved in practice by such class or category of source, whichever is more stringent." *Id.* at § 7501(3).

<sup>70</sup> *Id.* § 7479(3). In attainment areas, a permit granted for emissions from a new or modified major stationary source must use the standard of "best available control technology," which is defined as "an emission limitation based on the maximum degree of reduction of each pollutant . . . emitted from or which results from any major emitting facility, which the permitting authority, on a case-by-case basis, taking into account energy, environmental, and economic impacts and other costs, determines is achievable for such facility through application of production processes and available methods, systems, and techniques, including fuel cleaning, clean fuels, or treatment or innovative fuel combustion techniques for control of each such pollutant." *Id.*

<sup>71</sup> *Id.* § 7502(c)(1). Section 172(c) of the CAA, requires that plans for non-attainment areas "provide for the implementation of all reasonably available control measures as expeditiously as practicable (including such reductions in emissions from existing sources in the area as may be obtained through the adoption, at a minimum, of reasonably available control technology [RACT]) and shall provide for attainment of the national primary ambient air quality standards." *Id.* A definition of RACT is:

Reasonably Available Control Technology (RACT) means devices, systems process modifications, or other apparatus or techniques that are reasonably available taking into account (1) the necessity of imposing such controls in order to attain and maintain a national ambient air quality standard, (2) the social environmental and economic impact of such controls, and (3) alternative means of providing for attainment and maintenance of such standard.

40 C.F.R. § 51.100(o) (1991).

Reduction Technology.<sup>72</sup> The more severe the pollution problem, the more stringent the technological standard to be applied. Although those air standards differed from those adopted under the CAA in that they would not be determined on a uniform, national basis but rather facility by facility, they mirrored the innovation of the Water Act: they examined, and required, the best available alternative.

In 1990, Congress moved again to strengthen the Clean Air Act with a focus on the intractable problem of abating toxic emissions. As described earlier but with particular impact on air programs, the "risk management" approach to the regulation of air toxins had fallen of its own weight.<sup>73</sup> In the debates, legislators were presented with the two, by-now classic options in pollution control: renewed reliance on risk-based standards, or on best available technology.<sup>74</sup> In a resolution similar to that arrived at for water pollution twelve years earlier, Congress retained the ambient air approach as a back-up device,<sup>75</sup> but put its money and its immediate deadlines on

---

<sup>72</sup> 42 U.S.C.A. § 7591(b)(2). Under EPA regulations, a new or modified major stationary source must install the best available retrofit technology (BART) on major stationary sources that may reasonably be anticipated to cause or contribute to impairment of visibility in a mandatory Class I area. 40 C.F.R. § 51.302(c) (1991). "Best Available Retrofit Technology (BART) means an emission limitation based on the degree of reduction achievable through the application of the best system of continuous emission reduction for each pollutant which is emitted by an existing stationary source." *Id.* § 51.301(c).

<sup>73</sup> *Natural Resources Defense Council, Inc. v. EPA*, 824 F.2d 1146, 1163-64 (D.C. Cir. 1987).

<sup>74</sup> See generally Henry A. Waxman, *An Overview of the Clean Air Act Amendments of 1990*, 21 ENVTL. LAW 1721 (1991) (discussing legislative history of CAA Amendments of 1990).

<sup>75</sup> 42 U.S.C.A. § 7411(b)(1) states:

The Administrator shall . . . publish (and from time to time thereafter shall revise) a list of categories of stationary sources. He shall include a category of sources in such list if in his judgment it causes, or contributes significantly to, air pollution which may reasonably be anticipated to endanger public health or welfare.

. . . [T]he Administrator shall publish proposed regulations establishing Federal standards of performance . . .

See also *id.* § 7412(f) (directing EPA to report, by November 15, 1996, methods of calculating public health risks, public health significance of that risk, actual health effects of those risks, and legislative recommendations. If Congress fails to act on EPA's



requirements for Maximum Available Control Technology.<sup>76</sup> Large airshed or small, windswept or inversion-prone sources emitting over tons of toxic pollutants, that Congress went on itself to list,<sup>77</sup> would be subject to a new, national determination of the best alternative means of reduction.

The federal program for managing the disposal of hazardous wastes, the Resources Conservation and Recovery Act, has also evolved in a similar fashion. As originally designed in 1976, the Act would regulate the disposal of wastes by tracking them "from cradle to grave" through a manifest system, and by providing standards for the "graves" that ensured their safety.<sup>78</sup> By the following decade, however, it became clear that we were doing a good job tracking these wastes to landfills that, in turn, were becoming so contaminated that they had already begun to leak beyond their boundaries and form the cadre of a new round of Superfund sites.<sup>79</sup> In re-authorizing

---

recommendation, EPA can set standards required to provide an "ample margin of safety" to human health).

<sup>76</sup> *Id.* § 7412(d)(3). For hazardous air pollutants, some of which Congress listed in the Amendments, allowable emission standards are formulated according to the Maximum Achievable Control Technology (MACT), which is equivalent to:

the average emission limitation achieved by the best performing 12% of the existing sources (for which the Administrator has emissions information), excluding those sources that have, within 18 months before the emission standard is proposed or within 30 months before such standard is promulgated, whichever is later, first achieved a level of emission rate or emission reduction which complies, or would comply if the source is not subject to such standard, with the lowest achievable emission rate . . . applicable to the source category and prevailing at the time, in the category or subcategory for categories and subcategories with 30 or more sources, or (B) the average emission limitation achieved by the best performing 5 sources (for which the Administrator has or could reasonably obtain emissions information) in the category or subcategory for categories or subcategories with fewer than 30 sources.

*Id.*

<sup>77</sup> *Id.* § 7412(b)(1).

<sup>78</sup> See Solid Waste Disposal Act (SWDA) § 3002, 42 U.S.C.A. § 6922 (West Supp. 1993) (manifest requirements); 42 U.S.C.A. § 6924(d) (landfill requirements); see also, 51 Fed. Reg. 40,572 (1986) (final rules for landfill disposal). For a discussion of RCRA's early requirements, see JOHN QUARLES, FEDERAL REGULATION OF HAZARDOUS WASTES: A GUIDE TO RCRA 3-12 (1986).

<sup>79</sup> The literature (and the law books) abound with stories and cases where landfills have begun leaching contaminants into ground water requiring remediation and in

the Act, Congress withdrew its emphasis on "safe" disposal and turned instead, to a complex timetable for the phaseout of the disposal of toxic or hazardous materials, referred to collectively as the "landban."<sup>80</sup> Unfortunately for those who were, in fact, serious about banning the land disposal of these wastes, Congress provided a loophole in its amendments that allowed land disposal to continue if the wastes were subject to "pretreatment."<sup>81</sup> Congress defined "pretreatment" as treatment to "substantively diminish the toxicity of the waste . . . short-term and long-term threats to human health are minimized."<sup>82</sup> The stage was now set for the EPA to develop health risk levels for various pollutants at various sites, an exercise that, as earlier described, frustrated the development of toxic standards for air and water discharges and, as described by almost every knowledgeable observer of or participant in the Superfund cleanup process, has walked that program into a nightmare of time-consuming, expensive and inconclusive risk management decisions.<sup>83</sup> Despite Congress' direction that the EPA minimize

---

some instances designation as Superfund cleanup sites. See, e.g., *Arizona v. Motorola, Inc.*, 805 F. Supp. 749, 751-54 (D. Ariz. 1992) (state seeking to recover \$54 million in cleanup costs of landfill); *City of New York v. Exxon Corp.*, 766 F. Supp. 177, 196 (S.D.N.Y. 1991) (involving oil leachates in "soil, groundwater, and surface waters surrounding . . . landfills"); see also *Superfund: Landfill Releases Covered by Insurance Policy When Leachate Not Known Pollutant, Court Says*, [Current Developments] Env't Rep. (BNA) No. 22, at 1775 (Nov. 15, 1991) (stating that insurance pollution exclusion clause did not prevent coverage of Superfund site since leachate was not known pollutant at time of contract execution); *Superfund: Ability to Release Toxin Need Not be Shown, Court Says in Ruling Alloy is CERCLA Waste*, [Current Developments] Env't Rep. (BNA) No. 22, at 1654 (Nov. 1, 1991) (describing federal district court decision holding that waste not hazardous under Resource Conservation and Recovery Act may still be hazardous so as to create Superfund liability).

<sup>80</sup> 42 U.S.C.A. § 6924(d). Section 6924(d) lists substances which cannot be disposed of in landfills, unless "it has been demonstrated to the Administrator, to a reasonable degree of certainty, that there will be no migration of hazardous constituents from the disposal unit or injection zone for as long as the waste remains hazardous." *Id.* § 6924(d)(1). The same prohibition is applied to another group of specified solvents and dioxins. *Id.* § 6924(e). Under 42 U.S.C.A. § 6924, certain materials were to be phased out immediately and others on schedules over a fixed period of months. *Id.* § 6924(d).

<sup>81</sup> *Id.* § 6924(m).

<sup>82</sup> *Id.*

<sup>83</sup> There is general consensus that Superfund costs of cleanup are severely underestimated and cleanups, especially those funded by taxpayers, are subject to

"threats to human health and the environment," the EPA chose to require that hazardous wastes be pre-treated to levels based on Best Demonstrated Available Technology,<sup>84</sup> an examination of alternative treatment processes, whatever their perceived effects. The EPA's approach was challenged by the Hazardous Waste Treatment Council, leading to the supposition that at least the Council's members believed that the alternative's approach would be more stringent.<sup>85</sup> The U.S. Court of Appeals for the District of Columbia approved the EPA's approach, noting "EPA's catalogue of the uncertainties" in using health-risk-based standards.<sup>86</sup> The upshot is that we have not phased out the land disposal of hazardous wastes. Like air and water discharges, we require their treatment by the best alternative means available.<sup>87</sup>

Smaller programs in the galaxy of pollution control are also, belatedly, turning to alternative-based solutions. Two of the more important and more difficult of these programs are those for municipal storm-water runoff and for pollution from

---

massive overruns. *Superfund: Costs of Waste Cleanups Underestimated, Especially if Federally Funded, Study Finds*, [Current Developments] Env't Rep. (BNA) No. 21, at 1485 (Nov. 30, 1990). A major reason for the uncertainties and expenses in this program is the uncertainty of the degree of cleanup required, predicated on a complex risk assessment at the site. Various experts have offered suggestions on how to reform Superfund, among them allowing EPA to select cleanup sites based on a "return on investment" analysis, centralizing the selection of remedies, and eliminating retroactive liability. *A Superfund Wish List*, ENVTL. FORUM, Sept.-Oct. 1993 at 30; see, e.g., Donald A. Brown, *What is Wrong with the 1990 National Contingency Plan?*, 20 Env'tl. L. Rep. (Env'tl. L. Inst.) 10,371 (Sept. 1990); *Serious Problems Remain in Cleanups, Environmental Industry Group Says in Report*, [Current Developments] Env't Rep. (BNA) No. 20, at 1817 (Mar. 2, 1990); *Superfund: Witnesses Tell Senate Panel They Support Replacement of ARARs With National Standard*, [Current Developments] Env't Rep. (BNA) No. 24, at 878 (Sept. 17, 1993).

<sup>84</sup> Regulations prescribing BDAT are found in 51 Fed. Reg. 40,572 (1986).

<sup>85</sup> *Hazardous Waste Treatment Council v. S.E.P.A.*, 886 F.2d 355, 366 (D.C. Cir. 1989), *cert. denied*, 498 U.S. 849 (1990).

<sup>86</sup> *Id.* at 363.

<sup>87</sup> In what could be seen as a partial retreat from its technological BDAT standards for the RCRA land ban, EPA subsequently relented in its rule-making on many of the wastes involved and allowed them to be diluted, as "treatment," to the point that they were no longer hazardous. Although environmental groups challenged the dilution-as-treatment program, one court has rebuffed this argument. *Chemical Waste Management v. EPA*, 976 F.2d 2 (D.C. Cir. 1992), *cert. denied*, 113 S. Ct. 1961 (1993).



agriculture construction and land development. Storm-water and other nonpoint sources have proven to be particularly intractable problems because they are not easily susceptible to "tail-pipe" controls,<sup>88</sup> and because the two major responsible parties, financially-strapped cities and the American farmer, are as close to immunity as one gets in our political system. In consequence the CWA was careful from the outset to sever the regulation of nonpoint source pollution from BAT regulation and instead to fund a series of ineffectual studies and plans for nonpoint treatment measures.<sup>89</sup> The studies went nowhere.<sup>90</sup> By the late 1980s, with private industries and public sewage treatment systems spending heroic amounts of money to abate their shares of the nation's water pollution. The mounting evidence that storm runoff was in some cases cancelling out water quality improvements<sup>91</sup> and that farm runoff was, by volume, the largest contributor to water pollution in entire regions impelled Congress to address at least half of the problem.<sup>92</sup> New section 1342(p) of the Water Quality Act<sup>93</sup> required permits for municipal storm sewers to the Maximum Extent Practicable, considering "management practices, control techniques and system, design and engineering methods."<sup>94</sup> Since that time, facing a congregation of unhappy municipali-

---

<sup>88</sup> See ANDERSON ET AL., *supra* note 10, at 377-78.

<sup>89</sup> See 33 U.S.C.A. § 286; see also ANDERSON ET AL., *supra* note 10, at 384-87.

<sup>90</sup> See ANDERSON ET AL., *supra* note 10, at 386 (concluding "[t]he [§ 208] program is currently moribund").

<sup>91</sup> *Toxic Pollutants Concern Most States But Water Quality Better Overall*, EPA Says, [Current Developments] Env't Rep. (BNA) No. 14, at 1831 (Feb. 24, 1984) ("Nonpoint source pollution . . . continues to degrade the waters of most states and comprises 'the most important cause of water degradation' in about 10 states"); see *Sierra, NWF Urges Water Mandate*, NAT'L WILDLIFE FED. LEADER, Aug. 1983, at 6, ("Thirty-seven states have reported to the . . . EPA that nonpoint sources are the major factors interfering with attainment of water quality standards"); Thompson, *Poison Runoff*, ENVTL. FORUM, July-Aug. 1989, at 5 ("experts have known for years that polluted runoff is the primary reason why nearly half of our nation's surface water, and substantial amounts of our ground water, continue to be contaminated"). See generally OFFICE OF TECHNOLOGY ASSESSMENT, WASTES IN MARINE ENVIRONMENTS 123-40 (1987).

<sup>92</sup> Water Quality Act of 1987, 33 U.S.C.A. § 1329 (nonpoint sources); § 1342(p) (municipal nonpoint sources).

<sup>93</sup> *Id.* § 1342(p).

<sup>94</sup> *Id.* § 1342(p)(3)(B)(iii).

ties, EPA regulators have required under MEP only that cities characterize the nature of their discharges and develop their own proposals for remediation.<sup>95</sup> A more relaxed process for assessing alternatives would be hard to imagine, and it is equally hard to foresee measurable improvements in the near future, but section 1342(p) at least initiates a dialogue on alternative courses of action.

Congress' approach to agricultural and other nonpoint source pollution has been equally tentative, but it shows the same, inexorable shift to the examination of alternative technologies. In this case, Congress has tiptoed up to the problem not through the CWA but, rather, through the CZMA. This is a reflection of the fact that the federal coastal zone management program was up for re-authorization in 1990, ahead of the CWA, and that the effects of agricultural pollution are strongly felt in the nutrient-loaded estuaries and bays along our coasts.<sup>96</sup> The CZMA provides federal assistance for state coastal zoning programs and is thus more properly considered in the natural resources law discussion below. In 1990, however, Congress added section 6217 to the CZMA specifically to address the impacts of nonpoint pollution on coastal waters.<sup>97</sup> At bottom, this section requires "management measures" for nonpoint sources in the coastal zone that reflect "the

---

<sup>95</sup> 40 C.F.R. § 122.26(d) (1993).

<sup>96</sup> WASTES IN MARINE ENVIRONMENTS, *supra* note 91, at 123-40; *see also* COASTAL ZONE IMPROVEMENT ACT OF 1989: HEARINGS ON S. 1189 BEFORE THE NATIONAL OCEAN POLICY STUDY OF THE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION, 101st Cong., 2d Sess. 31-137 (1990). "Coastal pollution, and specifically nonpoint source pollution, which arises from the pattern of land use and development, is a major cause of degrading coastal water quality . . ." *Id.* at 36-37 (statement of Virginia K. Tippie, Assistant Administrator for Ocean Services and Coastal Zone Management, National Ocean and Atmospheric Administration). "It is clearly time to bite the bullet on nonpoint pollution and other land use related issues which affect our coastal resources. The question is are the teeth sharp and the jaws up to the task." *Id.* at 109 (statement of Dallas Miner, Vice President, American Fishing Tackle Manufacturers Association). "Nonpoint source pollution [is] the most difficult to regulate and control. Runoff from farms, septic tanks, parking lots, and construction sites, to name a few, are the major contributors of key pollutants ending up in our marine waters." *Id.* at 129 (statement of Andrew Palmer, Director, American Oceans Campaign).

<sup>97</sup> 16 U.S.C.A. § 1455(b).

greatest degree of pollution reduction achievable through the application of the best available nonpoint pollution control practices, technologies, processes, siting criteria, operating methods, or other alternatives," BANPCP.<sup>98</sup> While these technologies are to be established by each state on the basis of federal guidance, the legislative history of this section makes it clear that Congress, once again, has rejected a water-quality based approach as unworkable and turned, instead, to technological alternatives.<sup>99</sup>

At this point in the evolution of federal pollution control law, we view an assortment of alternative-based standards including BAT, LAER, BACT, RACT, BART, MACT, BADT, MEP and BANPCP, in order of their appearance in this discussion, with perhaps more to come. The assortment is bewildering at first blush, and bewildering at second blush, but less so when these standards are perceived as experimental forms all seeking to do similar things, arrived at through trial and error, and winning their primacy because other approaches simply couldn't hold their terrain. This is not to say that ambient-based and other approaches do not survive. Absent a cataclysmic event, evolution rarely eliminates less successful forms overnight. In fact, ambient environmental and health-based standards play useful supporting roles, more as scavengers than as predators, in federal water, air and waste control programs. Conversely, however, those laws whose success remains predicated on the determination of acceptable health and environmental risks, such as FTSCA and FIFRA, remain confined to small ecological niches, stymied by the impossibility

---

<sup>98</sup> *Id.*

<sup>99</sup> H.R. REP. 605, 101st Cong., 2d Sess., 29-30, at 29-30 (1990).

This Committee's fundamental objective underlying section 207 of the legislation is to require EPA to develop technical guidance on the best available pollution control measures for nonpoint sources. This guidance would serve as a basic "cookbook" of alternatives that State and local officials could use as they fulfill their water pollution control obligation under this Act and the Clean Water Act.

*Id.* at 29; see Jack H. Archer, *Evolution of Major 1990 CZMA Amendments: Restoring Federal Consistency and Protecting Coastal Water Quality*, 1 TERR. SER. J. 191, 191 (1991) (stating committee report became basis for § 1455(b)).



of the very determinations required and reversed regularly by courts of law the few times that such determinations are offered.<sup>100</sup> The one flourishing example of a risk-oriented program gone wild as a weed on 2-4-5-T, a herbicide that kills by causing the plant to outgrow its support system, is of course CERCLA, whose burden of risk-based decision-making may yet bring it down.<sup>101</sup>

These conclusions do not deny the importance of science to pollution control programs. As an increasing number of Congressional and agency decisions appreciate, these conclusions simply confirm the fact that science is unable to go so far as to set ultimate, arithmetic pollution levels for the safety of ourselves or our environment. On the other hand, science is more than able, and indeed is the best-qualified discipline available, to determine priorities for pollution control expenditures and to signal when and where unattended and under-attended (and over-attended) problems lie.<sup>102</sup> A national ambient air standard for a compound such as lead is at best a will'o-the-wisp, and at worst a fraud.<sup>103</sup> A national warning that lead is so toxic that it needs priority abatement, and an international warning that atmospheric ozone depletion by

---

<sup>100</sup> See *Corrosion Proof Fittings v. EPA*, 947 F.2d 1201, 1222-30 (5th Cir. 1991) (reversing EPA regulation of asbestos); *Shell v. EPA*, 826 F.2d 295, 296-98 (5th Cir. 1987) (reversing EPA regulation of mesityl oxide).

<sup>101</sup> See *supra* notes 7, 83.

<sup>102</sup> See generally CARL F. CRANOR, *REGULATING TOXIC SUBSTANCES: A PHILOSOPHY OF SCIENCE AND THE LAW* 83-151 (1993).

<sup>103</sup> PERCIVAL, *supra* note 40, at 440 (illustrating guesswork that went into arithmetic-appearing lead standard); see *Natural Resources Defense Council, Inc. v. Costle*, 568 F.2d 1369, 1371-83 (D.C. Cir. 1977) (describing manipulation possible in ozone standard).

chlorofluorocarbons could soon be irreversible,<sup>104</sup> are science at its best.

Alternatives have evolved as the key to effective pollution control. Other methods will doubtless follow and some, alluded to at the close of this paper, are already sniffing around the jungle floor. But our experience to date leads us not only to rely on an examination of alternative technologies but also to a hierarchy of examinations, based upon our perception of the threat and of the politics of regulation:

*Tier One.* Those pollution sources such as agriculture and existing facilities in clean-air areas that are seen as harmful but not life-threatening, and whose regulation carries steep political price tags, receive a deferential examination of alternatives, essentially site-specific, with loose federal oversight. In the same vein, municipal runoff is at this stage a largely review-it-yourself exercise.

*Tier Two.* As we move up into non-attainment areas under the CAA however, and into toxic discharges and the disposal of hazardous wastes, the drill becomes more rigorous. Alternatives are examined by an independent agency and based on abatement techniques available nationwide.

*Tier Three.* In rare instances and at its most stringent, pollution control law will by-pass the examination process and simply compel the selection of alternatives, for example through prohibitions on the manufacture, use or discharge of DDT, PCBs, leaded gasoline and, most recently, CFC's . . . pollutants perceived as posing immediate and acute harm. In hindsight,

---

<sup>104</sup> See J.G. Anderson et al., *Free Radicals Within the Antarctic Vortex: The Role of CFCs in Antarctic Ozone Loss*, SCIENCE, Jan. 4, 1991, at 39, 39-46 (noting link between CPCs and ozone depletion in Antarctic stratosphere each spring); J.E. Cox and Charles R. Miro, *Worsening Ozone Layer Outlook Points to Quicker CFC Ban*, ASHRAE J., Feb. 1992, at 12, 12; OZONE DEPLETION, SKY & TELESCOPE, June 1988, at 596, 596 (outlining how relationship between CFCs and ozone destruction led to Montreal Protocol); *Ozone Destruction Closer to Home*, SCIENCE, March 16, 1990, at 1297, 1297 (recent support for theory); F. Sherwood Rowland, *Chlorofluorocarbons and the Depleting Stratospheric Ozone*, AMERICAN SCIENTIST, Jan.-Feb. 1989, at 36, 36-45 (survey of research findings on relationships between CFCs and ozone depletion); Gary Taubes, *The Ozone Backlash*, SCIENCE, June 11, 1993, at 1580, 1580-83 (discussing use of "junk science" to delay response to ozone depletion).

two consequences of these prohibitions have become clear. The first is that, quite quickly, the background levels of these pollutants crash;<sup>105</sup> the prohibitions are effective. The second is that in every case the industry responsible for the production and use of these pollutants, usually the primary opponent of their regulation, has found alternative means of producing pesticides, batteries, gasoline or refrigerators; the alternatives are available.<sup>106</sup> Indeed, in some cases they save money as well.<sup>107</sup> Viewed against this experience, pollutant prohibitions are not bans of an industry or a process; they are simply a forceful means of compelling alternatives.

---

<sup>105</sup> Commoner, *supra* note 59, at 10,197 t.III (noting correlation between discharge bans and ambient pollution reductions). Note the reductions from 70 to 92% for lead, DDT, PCTs, mercury, strontium 90 and phosphates. *Id.*

<sup>106</sup> See generally 1990 COUNCIL ON ENVTL. QUALITY ANN. REP. 21 (regarding pollution reduction initiatives). The progress on reducing CFCs in the electronic industry is more rapid than anyone predicted, despite earlier industry claims that alternative processes were not available. Andrew Pollack, *Moving Fast to Protect Ozone Layer*, N.Y. TIMES, May 15, 1991, at D1, D2. "If the federal government set a goal that there would be no fossil fuels sold by 1994, I bet you would see electric cars by then." *Id.* at D1 (quoting George Allen, chemist in charge of CFC reduction in Apple Computer, Inc.). "Companies that had been slow in reducing toxic x are being more cooperative in an effort to win bonus points [from tax reductions]: 'They're suddenly finding ways to reduce emissions that they couldn't find a week earlier.'" Peter Nicholas, *Polluters to Lose Tax Break*, TIMES-PICAYUNE, Apr. 25, 1991, at B2 (quoting Louisiana DEQ official John Glenn). Shell Oil Company faced this issue as follows:

A recycling program at Shell Chemical Company's complex here has cut the plant's toxic releases to the environment by 152.8 million pounds in one year. . . . Shell achieved the reductions by building a small plant at the complex that uses hydrochloric acid, formerly a waste product, to produce calcium chloride, which can be used in drilling operations . . . the recycling operation, which turns toxic waste into a salable commodity, is "slightly profitable" for Shell. Shell officials decided to look at alternative disposal methods in 1985, at a time when stricter regulation of injection was anticipated.

Shinkle, *Shell Oil Officials Expect Recycling Program Will Cut State's Toxic Emissions by 20 Percent*, BATON ROUGE STATE TIMES, Sept. 13, 1990, at 1A.

<sup>107</sup> *General Policy: Major U.S. Companies Voice Concern About Poor Image in Environmental Issues*, [Current Developments] Env't Rep. (BNA) No. 22, at 1779 (Nov. 15, 1991); see also *Two Voluntary Pollution Control Programs Said to Yield Better Results than Regulation*, [Current Developments] Env't Rep. (BNA) No. 15, at 169 (Mar. 25, 1992); *Industry Success Cited in EPA Report; Data Lacking for Thorough Policy Assessment*, [Current Developments] Env't Rep. (BNA) No. 22, at 1777 (Dec. 13, 1991).



All of this said, alternatives-based programs carry within themselves the seeds of their own mortality. These seeds will become apparent after an examination of the parallel evolution of national resources programs, the other hemisphere of environmental law.

### III. NATURAL RESOURCES MANAGEMENT AND ALTERNATIVES STANDARDS

Every region of the country has a story to tell of the use and misuse of its natural resources.<sup>108</sup> For every story there is a sequel, now in progress, of environmental law, trying in one fashion or another to change the endings.<sup>109</sup> These sequels of law make up a theater of experimentation and evolution separate from pollution control, and one whose outcome is, if anything, even more in doubt.

The region with which this author is most familiar is the Lower Mississippi Delta, which holds one-third of the nation's coastal marshes, hosts nearly half of its migratory waterfowl at some point in their annual flights, and produces nearly one-quarter of its seafood, including the Gulf shrimp fishery, our most valuable commercial harvest.<sup>110</sup> On the first recorded visit to the Lower Mississippi by a European man, Hernando de Soto saw the River in high flood, a reported sixty miles wide, and that spectacle sent the Spanish to colonize safer ground in the Floridas.<sup>111</sup> In the early 1600s, however, the French were

---

<sup>108</sup> See generally STEWART L. UDALL, *THE QUIET CRISIS* 54-68 (1963) (giving history of exploitation of nation's forests, soil, water and mineral resources).

<sup>109</sup> See generally GEORGE C. COGGINS ET AL., *FEDERAL PUBLIC LAND AND RESOURCES LAW* 334-839 (3d ed. 1993); CHARLES E. WILKINSON, *CROSSING THE NEXT MEDIAN* (1992) (proposing solutions to natural resources problems).

<sup>110</sup> LOUISIANA COASTAL WETLANDS CONSERVATION AND RESTORATION TASK FORCE, *LOUISIANA COASTAL WETLANDS RESTORATION PLAN: MAIN REP. AND ENVTL. IMPACT STATEMENT* 25-27 (June 1993) [hereinafter *LOUISIANA COASTAL WETLANDS RESTORATION PLAN*]; see also WALTER B. SIKORA, *AIR CUSHION VEHICLES FOR THE TRANSPORT OF DRILLING RIGS, SUPPLIES, AND OIL FIELD EXPLORATION OPERATIONS IN THE COASTAL MARCHES OF LOUISIANA* 1 (1988).

<sup>111</sup> KERMIT L. HEBERT, *LOUISIANA WATER RESOURCES RESEARCH INST., THE FLOOD CONTROL CAPABILITIES OF THE ATCHAFALAYA BASIN FLOODWAY* 13-15 (1967); see also HODDING CARTER, *LOWER MISSISSIPPI* 13-23 (Stephen V. Benet & Carl Carmer eds., 1942).

back and established a post at New Orleans protected by a small levee.<sup>112</sup> We have been building those levees ever since. In the mid-1800s they were extended to the Gulf of Mexico for navigation, and began to sever the surrounding marshes from the soils and nutrients they had received from the Mississippi for the previous 5,000 years.<sup>113</sup> In the mid-1900s we began to channelize these marshes to access oil and gas deposits, thousands of miles of canals criss-crossing this coastal zone in a manic grid, and for all of these reasons, large and small, the marshes began to collapse.<sup>114</sup> The Louisiana coast is simply disappearing. The rate of collapse is astonishing, averaging nearly thirty square miles a year.<sup>115</sup> The loss to the nation will be irreplaceable. What is most sad is that, looking around the continent, it is by no means unique.

This same scenario of natural resources mismanagement has been replayed across nearly all of the primary ecosystems of the United States. We cut down the great canopy of eastern forest that stretched from the Atlantic to St. Louis and from the Great Lakes to Mississippi and then moved on to the Ponderosa, the Lodgepole and the Redwoods and destroyed them so efficiently that the only significant stands remaining are those found in holdings originally protected by the President of the United States as "antiquities" and withdrawn as "preserves;"<sup>116</sup> we are now arguing over the fate of the last originals, the old-growth forest of the Pacific Northwest.<sup>117</sup> We have stripped river systems the size of the Missouri and the

---

<sup>112</sup> CARTER, *supra* note 111, at 24-120.

<sup>113</sup> *Id.*

<sup>114</sup> See SIKORA, *supra* note 110, at 16; see also Oliver A. Houck, *Land Loss in Coastal Louisiana: Causes, Consequences, and Remedies*, 58 TUL. L. REV. 3, 30-33 (1983).

<sup>115</sup> See LOUISIANA COASTAL WETLANDS RESTORATION PLAN, *supra* note 110, at 13 (discussing recent Corps study showing increase in estimated rate of loss to 34.9 square miles per year); Mark Schleifstein, *Plan to Nip Coastal Loss Flows Along*, TIMES-PICAYUNE, Oct. 2, 1993, at A1.

<sup>116</sup> See UDALL, *supra* note 108, at 126-46; see also COGGINS ET AL., *supra* note 110, at 219-20.

<sup>117</sup> See Rowe Findley, *Will We Save Our Own*, NAT'L GEOGRAPHIC, Sept. 1990, at 106; see also Daniel J. Chason, *Whose Ancient Forest*, DEFENDERS MAG., Sept.-Oct. 1990, at 17.

upper Mississippi of their adjacent wetlands, leveed them tight, built right down to the water-line, and are now surprised by the largest flood losses in history.<sup>118</sup> We plowed under prairies which supported grasses four feet high, so high one needed to ride on horseback to see over them, and converted them into the great dust bowl disasters of the 1920s and 1930s,<sup>119</sup> a crescendo of wind and soil erosion against which we still struggle today.<sup>120</sup> We put cattle on the short grass prairies and turned

---

<sup>118</sup> H. Josef Hebert, *Clinton Order Stresses Alternatives to Levees*, TIMES-PICAYUNE, Aug. 26, 1993, at A6.

For the better part of a century, the White House and Congress have poured more than \$25 billion into dams and levees maintained by the Army Corps of Engineers and local builders on the banks of the Mississippi, Missouri, Illinois and other rivers. The engineers and policy makers ignored the repeated warnings that the levees were actually a mixed blessing: that while they contained some cresting waters, they increased the chances of greater flooding downstream by drying up wetlands, changing the river channel and increasing the force of the river.

*Id.*; see Stephen Labaton, *Government Studies Buying Flooded Areas*, TIMES-PICAYUNE, Aug. 28, 1993, at A3; see also Drummond Ayres, Jr., *What's Left From the Great Flood of '93*, N.Y. TIMES, Aug. 10, 1993, at A1, B8.

<sup>119</sup> See UDALL, *supra* note 108, at 173-87; see also Ian Frazier, *A Reporter at Large: The Great Plains-Part III*, THE NEW YORKER, Mar. 6, 1989, at 41.

So began the first of the great modern ecocatastrophes. The year 1933 was drier than 1932. Early in 1934, planting seemed ridiculous--plows turned up a dust as dry and fine as cornstarch. In February, the wind began to blow, and the dust began to fly. In mid-April, a giant dust cloud, back at the base and tan at the top, rose from the fields of eastern Colorado and western Kansas and began to move south. Inside the cloud, darkness was total, and remained for hours after the cloud passed. People in the cloud's path thought the end of the world had come, and went to churches to await it. The storm left dead birds and rabbits in its wake, and drifts of dust six feet deep against the side of houses. On May 10th, another dust storm came up, on a wind from the west. This one blew all the way to the Eastern Seaboard, and blocked out the sun in New York City for five hours. People came home from work in an eerie half-light like the light during an eclipse. Dust got into the threads of water bottles and inside watch cases. Great Plains dust showered ships three hundred miles out in the Atlantic. All of Chicago was inches deep in it. That one storm dropped twelve million tons of plains topsoil on the city. All year, the dusts kept blowing.

*Id.* at 58.

<sup>120</sup> See UDALL, *supra* note 108, at 173-87.



them into a desert of cactus and sage;<sup>121</sup> nearly fifty percent of some western states is now so cropped it will no longer economically even support cattle.<sup>122</sup> The history of this nation's natural resources programs is a saga of single-minded exploitation underwritten, even today, by free public land,<sup>123</sup> royalty free mining,<sup>124</sup> below-cost federal water,<sup>125</sup> below-cost timber sales,<sup>126</sup> below-cost grazing fees,<sup>127</sup> below-cost hydro-power,<sup>128</sup> construction-cost-free navigation<sup>129</sup> and ninety percent federal highway construction monies,<sup>130</sup> a federal welfare

<sup>121</sup> *Natural Resource Defense Council, Inc. v. Morton*, 388 F. Supp. 829, 832-41 (D.C. Cir. 1974), *aff'd*, 527 F.2d 1386 (D.C. Cir.), *cert. denied*, 428 U.S. 913 (1976); see DENZEL & NANCY FERGUSON, *SACRED COWS AT THE PUBLIC TROUGH* 86 (1983); George C. Coggins, *The Law of Public Rangeland Management V: Prescriptions for Reforms*, 14 ENVTL. L. 497, 501 (1984).

<sup>122</sup> *Morton*, 388 F. Supp. at 832-41 (noting sources therein); see also COGGINS ET AL., *supra* note 109, at 501-02.

<sup>123</sup> See, e.g., The Desert Land Act of 1877, 43 U.S.C.A. § 321 et seq. (1988) (discussing free land for irrigation); The Reclamation Act of 1902, 43 U.S.C.A. §§ 371 et seq. (1988) (same); The Mining Act of 1872, 30 U.S.C.A. § 22 (1988) (discussing free land for mining). For a general discussion of these acts, see generally COGGINS ET AL., *supra* note 109.

<sup>124</sup> See General Mining Act of 1872, 30 U.S.C.A. § 22 (1988); DAVID SHERIDAN, COUNCIL OF ENVTL. QUALITY, *HARD ROCK MINING ON THE PUBLIC LAND* 1-2 (1977); see also Michael Satchell, *The New Gold Rush*, U.S. NEWS & WORLD REP., Oct. 28, 1991, at 44.

<sup>125</sup> The Reclamation Act of 1902, 43 U.S.C.A. § 432 (West 1986); see also *Natural Resources Defense Council v. Duvall*, 777 F. Supp. 1533, 1539-42 (1991) (discussing economic influence on farmers' use of ground water).

<sup>126</sup> *New Forest Service Management Scheme Proposed by Conservation Advocates*, LAND LETTER (U.S. Forest Svc., Wash., D.C.), Aug. 15, 1985, at 4, t.3; COGGINS ET AL., *supra* note 109, at 137-38.

<sup>127</sup> COGGINS ET AL., *supra* note 109, at 137-38 (discussing passage of Taylor Grazing Act); see Ayres, *supra* note 118, at A1.

<sup>128</sup> *Dams and Coal Hit the Age of Limits*, HIGH COUNTRY NEWS, July 1, 1992, at 2-3; see Robert E. Sullivan, Jr., *The Beautiful and the Dammed*, OUTSIDE, July 1992, at 54, 60.

<sup>129</sup> 33 U.S.C.A. § 702(b).

<sup>130</sup> P. BURWELL & M. WILNER, NAT'L WILDLIFE FED'N AND ENVTL. ACTION FOUND., INC., *THE END OF THE ROAD: A CITIZEN'S GUIDE TO TRANSPORTATION PROBLEMSOLVING* 11 (1977). Highway funding has recently been increased, and the federal-state allocations altered, by the Surface Transportation Act of 1991, Pub. L. No. 102-240, reprinted in 1991 U.S.C.C.A.N. (105 Stat.) 1914. *Id.*

system whose aggregate provides multi-million dollar subsidies<sup>131</sup> for companies the size of Del Monte and Weyerhaeuser, American Metals Climax and American Trucking Association, an encouragement to continue to use natural resources in ways that are not only inefficient and destructive but that are no longer even sustainable.<sup>132</sup> The challenge here, even more formidable than that faced by pollution control programs, has been to change the habits not only of industries but of entire regions.<sup>133</sup> The answers have evolved slowly and with a surprising congruity to those we have seen in pollution control.

The first answer and the best known is the National Environmental Policy Act.<sup>134</sup> It is hard to remember that, for years, NEPA was the most contentious, vilified and litigated environmental law in this country.<sup>135</sup> It has also become the most imitated environmental law of our century, paralleled in the legislation of more than half of our states<sup>136</sup> and by both

<sup>131</sup> Walter V. Reid, *The United States Needs a Biodiversity Policy*, (World Resources Instit., Feb., 1992); see also *Cleaning Up Interiors Mess*, THE LEADER, April 1993, No. 4, at 2 (citing federal subsidies for mining, grazing, irrigation, concessionaires, timber, natural gas, and other commodities).

<sup>132</sup> Clifford Krauss, *Clinton Planning to Increase Fees on Grazing Lands*, N.Y. TIMES, Aug. 10, 1993, at A1, A6. "Mr. Babbitt called the new fee 'a reasonable balance between the need to sustain the health of range land and the need to sustain the economic health of rural Western areas.'" *Id.* (quoting Interior Secretary Bruce Babbitt).

<sup>133</sup> This challenge is described on a monthly basis in the High Country News which regularly reports on natural resources issues in the changing American west. See generally HIGH COUNTRY NEWS, May 3, 1993.

<sup>134</sup> National Environmental Policy Act of 1969 (NEPA), 42 U.S.C.A. §§ 4321-4370 (West 1977 & Supp. 1993).

<sup>135</sup> For the jump in environmental litigation stimulated by NEPA see Richard A. Liroff, A NATIONAL POLICY FOR THE ENVIRONMENT (NEPA AND ITS AFTERMATH) 31-35 (1976). A Congressional staff member involved in the passage of NEPA is quoted: "If Congress had appreciated what the law would do, it would not have passed. They would have seen it as screwing public works. The timing of the bill complicated the way it worked. Had it passed a year earlier or later, things would have been far different." *Id.* at 35.

<sup>136</sup> At least sixteen states, the District of Columbia and Puerto Rico have enacted environmental policy acts or "Little NEPAs." See ARK. CODE ANN. §§ 8-1-101 to 8-10-301 (Michie 1987); CAL. PUB. RES. CODE §§ 21000-21178.1 (West 1982); CONN. GEN. STAT. ANN. §§ 22a-14 to 22a-20 (West Supp. 1974-75); D.C. CODE ANN. 36-7091 to 6-974 (West 1981); FLA. STAT. ANN. §§ 380.012-380.27 (West 1988); HAWAII REV. STAT. § 343-1 to 343-8 (West 1985); IND. CODE ANN. §§ 13-1-10-1 to 13-1-10-8 (West 1987); MA. CODE ANN. ch. 30, §§ 61-62H (West 1992); MINN. STAT. ANN. §§ 115.01-116R.13 (West 1977

the developed and the developing world.<sup>137</sup> Its bottom line requirement — that the environmental effects of a proposed action be disclosed — has become a predicate principle for international environmental law.<sup>138</sup> Why should such a requirement be controversial? For at least two reasons. First, this disclosure presumes including the general public<sup>139</sup> which had never been party to the great energy, transportation and other resource management decisions of this country, and the public, particularly the public in the neighborhood of the proposal, may have ideas of its own. The second reason is that the NEPA statement must discuss not only the proposal but alternative ways to achieve its objective.<sup>140</sup> This requirement is the unkindest cut of all.

---

& Supp. 1982); MONT. CODE ANN. §§ 75-1-101 to 75-1-105; § 75-1-201 (West 1981); N.Y. ENVTL. CONSERV. LAW §§ 8-00101 to 8-0117 (McKinney 1984); N.C. GEN. STAT. §§ 113A-1 to 10 (West 1978); P.R. LAWS ANN. tit. 12, §§ 1121-1127 (1977); S.D. CODIFIED LAWS ANN. §§ 34A-9-1 to 34A-9-12 (1992); VA. CODE ANN. §§ 10.1-1200 to 10.1-1212 (subject to redefinition by Virginia General Assembly in 1992); WASH. REV. CODE §§ 43.21C.010-43.21C.910 (1974), WASH. ADMIN. CODE N.R. § 197-11 (Michie 1984); WIS. ADMIN. CODE NR § 150.01-40. Another seventeen states and the District of Columbia have some type of limited environmental review requirements established either by statute, executive order, or other administrative directives; they are: Arizona, Arkansas, California, Delaware, District of Columbia, Georgia, Massachusetts, Michigan, New Jersey, North Carolina, North Dakota, Oregon, Pennsylvania, Rhode Island, South Dakota, Utah, Washington, and Wisconsin. See 1991 COUNCIL ON ENVTL. QUALITY TWENTY-FIRST ANN. REP. 42 (1991).

<sup>137</sup> Directive on the Assessment of the Effects of Certain Public and Private Projects on the Environment, 85/337/EEC, 27 June 1985; see 1990 COUNCIL ON ENVTL. QUALITY TWENTIETH ANN. REP. at 42-44 (stating environmental impact assessment system is model for comparable systems worldwide); William V. Kennedy, *Environmental Impact Assessment on North America, Western Europe What Has Worked Where, How, and Why*, Int'l. Env'tl. Rep., Apr. 13, 1988, at 257.

<sup>138</sup> See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, Part VI, The Law of the Environment, § 601(e) ("a state has an obligation to consult with another state if a proposed activity within its jurisdiction and control poses a substantial risk to the environment of the other state"), reprinted in EDITH B. WEISS ET AL., INTERNATIONAL ENVIRONMENTAL LAW: BASIC INSTRUMENTS AND REFERENCES 195-200 (1992).

<sup>139</sup> See *Calvert Cliffs Coordinating Comm. v. United States Atomic Energy Comm.*, 449 F.2d 1109, 1114 (D.C. Cir. 1971) (stating purpose of NEPA is to allow general public to see process).

<sup>140</sup> 42 U.S.C.A. 4322(2)(c)(ii) (West 1977).



To appreciate the bite of NEPA's alternative requirement, consider for example the current proposal of the Mississippi National Guard to conduct battalion-level armored vehicle maneuvers through the Leaf River Wildlife Management Area of the DeSoto National Forest in Mississippi.<sup>141</sup> These exercises will begin with clear-cutting the forest maneuver areas and end with the soil crossed by ruts and gullies up to twelve feet deep.<sup>142</sup> The environmental impact statement discusses several, small-scale alternatives to mitigate these impacts such as which streams may be avoided, which trees could be spared, and which nesting seasons might receive reduced vehicular traffic.<sup>143</sup> The alternative not discussed is the obvious one: maneuvering somewhere else.<sup>144</sup> The most logical alternative is the most intrusive, and the least desired by those proponents who see the maneuvers as a boon to the local economy. It is not difficult for any statement to allude, if minimally, to adverse environmental effects; it is far more difficult, as a matter of human nature and as a matter of tactics, for an agency to disclose that there could be a less damaging way.

The power of NEPA is that it has been incorporated — although at times by court order against strongly protesting agencies — into the decision-making processes of every federal natural resource and development program from fisheries management to highway construction to the use of public lands.<sup>145</sup> Whatever the mandates of the original programs —

---

<sup>141</sup> DEP'T OF THE ARMY, ENVTL. IMPACT STATEMENT, MILITARY TRAINING USE OF NATIONAL FOREST LANDS: CAMP SHELBY, MS (1991) [hereinafter DEP'T OF THE ARMY]

<sup>142</sup> *Id.* at 3-4, 3-5, 3-11, 3-125 to -128.

<sup>143</sup> *Id.* at 4-1 to 4-3.

<sup>144</sup> *Id.* at 1-39 to 1-40.

<sup>145</sup> See COUNCIL ON ENVTL. QUALITY, TWENTIETH ANN. REP., *supra* note 137, at 27-40 (influence of NEPA in improving U.S. Forest Service and Department of Defense programs); see also Denis Binder, *NEPA, NIMBY and New Technology*, 25 LAND & WATER L. REV. 11-12 (1990) ("[O]nly NEPA has the general applicability to encompass almost all federal government action. Thus, either in the absence of, or as a supplement to, a statute with specific applicability to a problem, NEPA has become the preferred statute of general appeal in environmental disputes"); Michael C. Blumm, *Symposium on NEPA at Twenty: The Past, Present, and Future of the National Environmental Policy Act*, 20 ENVTL. L. 447, 448-51 (1990) (discussing Supreme Court's decisions regarding NEPA).

and some of these mandates still date back to the last century — NEPA adds its new one,<sup>146</sup> and so proposed timber sales and grazing allotments, mineral leases and hydroelectric power plants will each be viewed under a new lens: What are the impacts, and is there a better way? It is *this* review, and not the requirements of the management statutes themselves, that has led to dramatic changes in natural resources management.<sup>147</sup>

In tandem with NEPA, and only two years prior to its enactment, Congress came up with a similar, but somewhat stronger remedy for the marked tendency of the federal-aid interstate highway program to select parks, historic and recreation areas as low-cost, convenient rights-of-way for new highway construction.<sup>148</sup> In section 4(f) of the Department of Transportation Act of 1968, Congress announced its intention that these areas be spared<sup>149</sup> and required that they be taken only if the Secretary of Transportation determined that "there is no feasible and prudent alternative to the use of such land."<sup>150</sup> This provision, reinforced by an early decision of the United States Supreme Court,<sup>151</sup> adds significantly to the requirements of an environmental impact statement under NEPA. At bottom, NEPA only requires the full disclosure of alternatives. Section 4(f) requires that — in the case of transportation facilities through public parks — less harmful alternatives be chosen unless there is no other way.

---

<sup>146</sup> 42 U.S.C.A. § 4335 (1988).

<sup>147</sup> See the continuing litigation over timber harvests in the Pacific Northwest, on National Forest inhabited by the Northwest Spotted Owl. Although challenges to National Forest plans, these cases are not based on the requirements of the National Forest Management Act but, rather, on those of NEPA. Victor M. Sher, *Ancient Forests, Spotted Owls, and the Demise of Federal Environment Law*, 20 Env'tl. L. Rep., (Env'tl. L. Inst.) 10,469, 10469-70 (Nov. 1990); see also *Wilderness Soc'y v. Babbitt*, 5 F.3d 383, 388-89 (9th Cir. 1993) (noting the effect of NEPA in reforming grazing on federal lands; *Morton*, 388 F. Supp. at 833-34 (noting requirement of environmental impact statements applies to grazing permit program)).

<sup>148</sup> S.R. REP. NO. 1340, 90th Cong., 2d Sess. 11 (1968), reprinted in 1968 U.S.C.A.N. (82 Stat.) 3482, 3492.

<sup>149</sup> 23 U.S.C.A. § 138.

<sup>150</sup> *Id.*

<sup>151</sup> *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 407-08 (1971).

Subsequent to NEPA, Congress and federal agencies responsible for implementing the Clean Water Act developed special protections against the impacts of dredge and fill operations in waters of the United States and, more particularly, in wetlands.<sup>152</sup> No ecosystem in North America is more important to this nation's commercial and biological productivity;<sup>153</sup> we are only beginning to appreciate its importance to flood control and sustainable growth.<sup>154</sup> No ecosystem of its original size is being destroyed so rapidly.<sup>155</sup> In response, under Section 404 of the Clean Water Act the U.S. Army Corps of Engineers and the EPA have developed a permit system intended to discourage wetland development.<sup>156</sup> While the vehicle for this program is a Corps permit, the permit decisions are guided by EPA regulations that prohibit dredge and fill in all waters where there are practicable alternatives to the activity, and where wetlands are concerned, go further to create a rebuttable presumption that such alternatives are available.<sup>157</sup> Corps decisions to issue a permit, further, are reviewable by the EPA and subject to its veto<sup>158</sup> based on either the impacts of a project or the availability of alternatives.<sup>159</sup> These regulations, ratified most recently in a memorandum between the Corps and the EPA requiring "sequencing" for permit decisions in which the first step in considering applica-

---

<sup>152</sup> 33 U.S.C.A. § 1344. See generally WILLIAM L. WANT, LAW OF WETLANDS REGULATION at 13-2 to 13-200 (1990) (describing state wetland laws and state laws implementing Coastal Zone Management Act).

<sup>153</sup> Michael R. Deland, *No Net Loss of Wetlands: A Comprehensive Approach*, A.B.A. NAT. RESOURCES & ENVTL. 3, 3-5 (1992).

<sup>154</sup> *Id.* at 3; see also the recent lessons provided by the Mississippi River flood of 1993, *supra* note 118 and accompanying text.

<sup>155</sup> Deland, *supra* note 153, at 3-4.

<sup>156</sup> 33 C.F.R. § 320.4(a)(1) (1993).

<sup>157</sup> 33 U.S.C.A. § 1344 (b)(1).

<sup>158</sup> *Id.* § 1344(c).

<sup>159</sup> *Id.* While § 404(c) of the CWA could be read to limit the veto to environmental effects EPA has interpreted this authority to include alternatives, an interpretation upheld in the courts. *Id.*; see *Bersani v. EPA*, 674 F. Supp. 405, 417 (N.D.N.Y. 1987), *aff'd* *Robichaud v. EPA*, 850 F.2d 36 (2d Cir. 1988), *cert. denied*, 109 S. Ct. 1556 (1989) (affirming EPA's use of "market entry theory" for regulating land development).



tions is "avoidance" of wetlands,<sup>160</sup> have been strongly resisted by real estate developers and construction agencies in a storm of controversy that has not yet abated.<sup>161</sup> The merits of this controversy aside, what is relevant here is that the section 404 regulations have taken the NEPA and section 4(f) requirements of review of alternatives one step farther. Under section 404, not only are non-wetland alternatives required to be chosen where practicable, but their evolution is conducted (1) by a federal agency independent of the applicant, at least in theory, (2) subject to public notice, review and comment, and (3) subject to review by an independent agency with the primary mission of protecting the environment, EPA. Not only do we have an alternatives mandate, we have a process.

The reliance of federal natural resources management laws on the consideration of alternatives reaches its apex in the program that seeks to protect living resources that are at greatest risk, threatened and endangered species.<sup>162</sup> Section 7 of the Endangered Species Act seeks to ensure that actions of federal agencies will not jeopardize species in these categories and, as originally enacted, simply prohibited jeopardy without exception.<sup>163</sup> Faced with the consequences of this prohibition, and in particular its arrest of a Tennessee Valley Authority dam in favor of an obscure, endangered species of fish, the snail darter,<sup>164</sup> Congress amended the Act to provide an exemption process that has since evolved into a two-step review of

---

<sup>160</sup> See generally William L. Want, *The Army-EPA Agreement on Wetlands Mitigation*, 20 *Envtl. L. Rep. (Envtl. L. Inst.)* 10,209 (June 1990) (summarizing wetlands protection agreement between EPA and Army Corps of Engineers).

<sup>161</sup> For a sample of this resistance at the time, see *Deluge of Mail Over Wetlands Plan*, WASH. POST, Jan. 15, 1990, at A17 (discussing outcry over White House plans to implement wetlands protection plan); John Lancaster, *Administration Delays Key Wetlands Protection Plans*, WASH. POST, Dec. 15, 1989, at A19 (reporting on suspension of agreement plans between EPA and Army Corps of Engineers). This resistance has led to continued pressure to amend the statute from representatives of wetlands development interests in Congress. H.R. REP. NO. 1330, 102d Congress, 1st Sess. (1991).

<sup>162</sup> 16 U.S.C.A. §§ 1531-1544.

<sup>163</sup> *Id.* § 1536(a)(2).

<sup>164</sup> *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 153 (1978).

activities seeking to go forward despite their impacts on endangered life forms.<sup>165</sup> The first review, conducted by the Secretary of Interior, is to examine "alternative courses of action consistent with conserving the species."<sup>166</sup> The Secretary's findings are in turn reviewed under the formal adjudicatory hearing requirements of the Administrative Procedure Act<sup>167</sup> by a seven-member Exemption Committee, a panel of federal and state representatives including the EPA and the President's Council on Environmental Quality.<sup>168</sup> An exemption may only be granted if five members of the Committee find in its favor on the basis of four statutory criteria.<sup>169</sup> The most objective criterion, and thus the most enforceable in law, is the requirement that there be no "reasonable and prudent alternative" to the project as proposed.<sup>170</sup> The strength of this process is reflected in the fact that only three projects have even sought exemption in the fifteen years since its enactment.<sup>171</sup> By unanimous votes of the Committee, an exemption was denied to Tellico Dam;<sup>172</sup> the Grayrocks Dam was exempted only with the adoption of new conditions on water releases for the whooping crane that constituted in effect an alternative operating regime.<sup>173</sup> Exemptions for thirty-one federal timber sales in the Pacific Northwest were denied, and thirteen were granted, in the face of jeopardy to the northern spotted owl,<sup>174</sup> a decision surrounded by evidence of undue

---

<sup>165</sup> 16 U.S.C.A. § 1536(h)(1).

<sup>166</sup> *Id.* § 1536(h)(1)(A)(ii).

<sup>167</sup> *Id.* § 1536(g)(6) (citing Administrative Procedure Act, 5 U.S.C.A. §§ 554-556).

<sup>168</sup> *Id.* § 1536(e).

<sup>169</sup> *Id.* § 1536(h)(1)(A).

<sup>170</sup> 16 U.S.C.A. § 1536(h)(1)(A)(i).

<sup>171</sup> Oliver A. Houck, *The Endangered Species Act and Its Implementation By the U.S. Department of Interior and Commerce*, 65 U. COLO. L. REV. 277, 297 (1993) [hereinafter *The Endangered Species*].

<sup>172</sup> MICHAEL J. BEAN, *THE EVOLUTION OF NATIONAL WILDLIFE LAW* 364-65 (2d ed. 1983).

<sup>173</sup> *Id.*

<sup>174</sup> Endangered Species Committee, Notice of Decision, 57 Fed. Reg. 23,405, 24,406 (1992).

political pressure and subsequently withdrawn.<sup>175</sup> In sum, to guard against federal natural resource management decisions adverse to endangered species, the Endangered Species Act turned not only to a substantive alternatives requirement but also to the review of compliance with this requirement by an independent review board subject to the most formal safeguards available in administrative law.

In recent years, a second prong of the ESA, section 9, prohibiting even private actions that would "take" an endangered species has received increasing attention.<sup>176</sup> This "taking" has been interpreted by federal agencies and the courts to include the taking of habitat essential to the survival of such a species,<sup>177</sup> with the result that section 9's prohibition now looks very much like section 7's prohibition against "jeopardy." At this point Congress felt the need to provide the same type of flexibility for private actions under section 9 that it had provided, through the exemption process, for section 7. This flexibility emerged in a new amendment authorizing the federal agencies responsible for protecting endangered species to permit private "takings," so long as they were accompanied by a "habitat conservation plan."<sup>178</sup> A key element of this required plan is that jeopardy to these species be avoided by the examination of alternative, harm-avoiding courses of action and, more specifically, "why [such courses of action] are not being utilized."<sup>179</sup>

---

<sup>175</sup> See Victor M. Sher, *Travels with Strix: The Spotted Owl's Journey Through the Federal Courts*, 14 PUB. LAND L. REV. 41, 57 (1993) (under new Administration BLM withdrew its application mooted case).

<sup>176</sup> 16 U.S.C.A. § 1538; see also, Robert D. Thornton, *Searching for Consensus and Predictability: Habitat Conservation Planning Under the Endangered Species Act of 1973*, 21 ENVTL. L. 605, 606 (1991) (discussing Endangered Species Act and its affect on institutions in United States).

<sup>177</sup> *Palila v. Hawaii Dep't of Land and Natural Resources*, 471 F. Supp. 985 (D. Haw. 1979) (*Palila I*), *aff'd*, 639 F.2d 495 (9th Cir. 1981) (*Palila II*); *Palila v. Hawaii Dep't of Land and Natural Resources*, 649 F. Supp. 1070 (D. Haw. 1986) (*Palila III*), *aff'd*, 852 F.2d 1106 (9th Cir. 1988) (*Palila IV*); see also, *Sweet Home Chapter of Communities for a Great Oregon v. Babbitt*, 1 F.3d 1, 4 (D.C. Cir. 1993) (upholding regulations prohibiting "taking" of endangered species).

<sup>178</sup> 16 U.S.C.A. § 1539; see also Thornton, *supra* note 176, at 606.

<sup>179</sup> 16 U.S.C.A. § 1539(a)(2)(A).



With these provisions, we have travelled about as far as the legal imagination currently takes us towards the protection of natural resources, short of an outright ban. The provisions chosen are major, but only illustrative. The fact is that as these alternative-based processes prove to at least influence decision-making and other approaches do not, more alternative-based processes appear. Regulations under the CZMA, for example, make alternatives the cornerstone for decisions on whether private actions such as oil leases are "consistent" with state coastal management programs, as the Act requires them to be.<sup>180</sup> Amendments to the Marine Mammal Protection Act require the incidental taking of marine mammals in purse seine fishing for yellowfin tuna to use the "best marine mammal safety techniques and equipment that are economically and technologically practicable" (BMMST).<sup>181</sup> New proposed legislation entitled the "Environmental Equal Rights Act of 1993,"<sup>182</sup> seeking to "prevent certain waste facilities from being constructed in environmentally disadvantaged communities,"<sup>183</sup> relies, *primero*, on a formal, adjudicatory finding that "there is no alternative location within the State for the proposed facility that poses fewer risks to human health and the environment."<sup>184</sup> Presidential Executive Orders designated to limit federal investment in flood prone areas<sup>185</sup> and in wetlands<sup>186</sup> generally each rely on findings by the agencies involved that no feasible non-floodprone and non-wetland alternative sites are available.

Within this flurry of legislative, Presidential and agency effort, and despite the great diversity of projects and activities which they seek to harmonize with environmental values, once

---

<sup>180</sup> 15 C.F.R. § 930.121 (requiring "no reasonable alternative" for activity inconsistent with State coastal management program).

<sup>181</sup> 16 U.S.C.A. § 1371(a)(2).

<sup>182</sup> H.R. REP. NO. 1924, 103d Cong., 1st sess. (1993).

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> Exec. Order No. 11,988, 42 Fed. Reg. 26,951 (1977) (allowing federal support only where no alternative to floodplain development exists).

<sup>186</sup> Exec. Order No. 11,990, 42 Fed. Reg. 26,961 (1977) (imposing duty upon federal agencies to minimize deterioration of wetlands).

again, as in the field pollution control, a rough hierarchy of alternatives-based requirements emerges:

*Tier one.* At the bottom, we have NEPA, applicable to all major federal actions, and therefore the least stringent, requiring only that alternatives be fully considered. As the history of NEPA compliance bears witness, however, even this requirement is an agony for agencies historically committed to programs with severe environmental impacts.

*Tier two.* In this category are laws that go further to require that, in order to protect discreet types of resources such as public parks, reasonable alternatives, if available, be chosen.

*Tier three.* Even more stringent are those laws designed to protect the rarest and most valuable of our living resources, wetlands and endangered species. Here the review of alternatives, with the power to deny, is conducted by agencies other than either the applicant or the action agency and, in the case of the Endangered Species Act, subject to full adjudicatory hearings.

*Tier four.* This last category includes natural resource areas that we have chosen to put off-limits to most forms of development, such as the National Park System and federal Wilderness Areas. The effect of these designations, albeit small in the aggregate, is to require some development proposals, such as mining, to go elsewhere, an effect similar to a ban on DDT and PCBs in pollution control law. As a practical matter, it bears noting that no ban is absolute; whatever Congress prohibits it can subsequently allow. In this light, even the ultimate in natural resources protection only serves to reserve the resource, and the argument, for another day.

#### IV. LIMITATIONS ON ALTERNATIVES: THE END OF AN EVOLUTIONARY LINE?

As much progress as alternative-based requirements have made in environmental law, they may not remain its primary workhorse in the coming decades. One reason is that the approach suffers a conceptual handicap: no one knows, under any statute, how far the alternatives inquiry travels. The inquiry is also limited, as a practical matter, by who is doing

the inquiring. Relatedly even where alternatives are available for the finding, the process is exhausting: the implementing agencies simply wear out. Last but not least, the approach relies on principles with which courts are uncomfortable and have begun to erode. Anyone attempting to predict the future of environmental law or to draft an improved model will need to address these difficulties.

*A. A Conceptual Problem: How Far Does the Inquiry Go?*

As seen above, pollution control statutes attempt to abate harmful emissions by requiring reductions achievable by application of, however acronymed BAT, or "best available technology." The CWA defines BAT as "taking into account" engineering technology, costs and other factors including "the process employed" and "process changes;"<sup>187</sup> its companion statutes call for the consideration of similar factors.<sup>188</sup> Despite this guidance, the scope of the inquiry remains unclear. Consider an activity common to Louisiana and Mississippi and equally common to the timber regions of the Great Lakes and the Pacific Northwest, the pulp and paper industry, which produces the whitest paper possible by bleaching the pulp with chlorine.<sup>189</sup> Unfortunately, this process also produces small amounts of dioxin in its waste waters, a contaminant that the EPA has characterized as "by far the most potent carcinogen

---

<sup>187</sup> 33 U.S.C.A. § 1314(b)(2)(B) reads:

Factors relating to the assessment of best available technology shall take into account the age of equipment and facilities involved, the process employed, the engineering aspects of the application of various types of control techniques, process changes, the cost of achieving such effluent reduction, non-water quality environmental impact (including energy requirements and other such facts as the Administrator deems appropriate).

The use of best available technology is mandated in the CWA. *Id.* § 1311(b)(2)(A).

<sup>188</sup> See, e.g., 42 U.S.C.A. § 7479(3). The CAA's best available control technology requirement for new sources in attainment areas is based on "the application of production process and available systems and techniques." *Id.* See generally *supra* notes 69-72 and accompanying text.

<sup>189</sup> *EPA Steps Up Dioxin Discharge Controls for Pulp, Paper Mills in New Strategy Document*, [Current Developments] Env't Rep. (BNA) No. 19, at 755 (Sept 2, 1988) (urging states to monitor and develop controls to limit dioxin levels in water).



evaluated to date by the Agency";<sup>190</sup> no identifiable threshold has been found safe for aquatic life.<sup>191</sup> Alternative engineering processes do exist to bleach paper with substances other than chlorine,<sup>192</sup> and there is, of course, commercial paper which is not "whiter-than-white" and is still quite serviceable for every purpose from hand towels to letterhead. The question is whether these alternative processes and products are "available" to plants that rely on a chlorine process. For chlorine-based plants, BAT may be limited to requiring settling ponds or filters for the discharge pipes to reduce (but not eliminate) the dioxin, or it may be broadened to require that oxygenation or another alternative process with less harmful side effects be used to bleach the paper. Conceivably, BAT review might find as "available" a society with less bleached paper. The most modest inquiry, settling ponds or filters, is also in most cases the least effective in abating pollution. More effective methods, leading to a different process or even a different product, are just as obviously the most intrusive. The success of an alternative-based pollution control strategy depends upon how far up the chain the alternatives inquiry is allowed to travel.<sup>193</sup>

---

<sup>190</sup> EPA, INTEGRATED RISK ASSESSMENT FOR DIOXINS AND FURANS FOR CHLORINE BLEACHING IN PULP AND PAPER MILLS 1 (July 1990), cited in *The Regulation of Toxic Pollutants*, supra note 31, at 10,549. The study also characterized Dioxin as the "most potent reproductive toxin yet evaluated by EPA." *Id.*

<sup>191</sup> 49 Fed. Reg. 5831 (1984).

<sup>192</sup> *Water Pollution: Little Risk Seen in Dioxin From Paper Mills; Tighter Regulations Expected Anyway*, EPA Says, [Current Developments] Env't Rep. (BNA) No. 1, at 5 (May 4, 1990).

<sup>193</sup> To continue the Dioxin example, Louisiana Pacific has reportedly opened a new mill in British Columbia that avoids Dioxin discharges by use of hydrogen peroxide in lieu of chlorine bleach. *Water Pollution: Louisiana-Pacific Opens Pulp Mill Designated to Eliminate Water Discharges*, [Current Developments] Env't Rep. (BNA) No. 22, at 1660 (Nov. 1, 1991). The question remains whether EPA will examine alternatives this broadly for the purpose of establishing its BAT requirement. For an indication that the EPA will do so, see *Effluent Limitations Guidelines, Pretreatment Standard, and New Source Performance Standards: Pulp, Paper, and Paperboard Category; National Emission Standards for Hazardous Air Pollutants for Source Category: Pulp and Paper Production*, 58 Fed. Reg. 66,078, 66,108 (Dec. 17, 1993) (proposing non-chlorination for subcategories of the pulp and paper industry). Consider, by way of another illustration, the question of abating automobile emissions. An inquiry that takes existing processes

Consideration of the broader range of alternatives in these statutes is handicapped not only by their ambiguity but also by their application to "categories" and "subcategories" of point sources.<sup>194</sup> Companies using a particularly harmful process may succeed in classifying themselves as a separate industrial group, e.g. the chlorine-bleach subcategory of the pulp and paper category, leading to a separate inquiry into BAT.<sup>195</sup> Once this inquiry accepts the chlorine process as a given, technological alternatives are reduced to arguments over tailpipe controls.

The scope of alternatives considered also determines their impact in the hemisphere of natural resources law. A ready example arises from the Mississippi National Guard's proposed armored vehicle maneuvers in the Leaf River Wildlife Management Area, noted above.<sup>196</sup> If alternatives review focuses on ways to mitigate the effects of tank squadrons on certain stands of trees it will offer little environmental protection indeed. If the review is expanded to consider alternative training sites in the project area the review may be equally ineffectual because few sites may exist. Once the review goes Mississippi-wide, however, less sensitive lands are likely to be available, and were the search to be conducted nationwide — where could battalion-level exercises best be conducted? — any number of low-impact zones come to mind. If allowed to travel freely, these inquiries can lead to surprising results even for the

---

as a given will result in catalytic converters and other tailpipe controls that are, at best, temporarily and marginally effective. A broader inquiry would consider alternative fuels and motor designs, and a broader one yet, alternative transportation systems. The broader alternatives are without doubt the most effective, and in some cases the only means of abatement with a real chance of maintaining air quality standards. They also require a degree of intrusion that, until recently, we have found unacceptable. *See* CAA Amendments of 1990, 42 U.S.C.A. § 7407 (allowing California and other states to adopt alternative automobile emission requirements).

<sup>194</sup> 40 C.F.R. § 125.3(c) (1992); *see also* *Weyerhaeuser Co.*, 590 F.2d at 1019 (stating EPA can limit effluent discharges of every category or class of existing point sources).

<sup>195</sup> 40 C.F.R. § 405.30(c) (1993) (discussing subcategory breakdown for cultured products industry).

<sup>196</sup> *See* DEPT OF THE ARMY, *supra* notes 141-44 and accompanying text.

original project sponsors, as illustrated by the recent Two Forks Reservoir controversy in Colorado.

One of the more celebrated environmental controversies in recent years involved a proposal by the city of Denver to build a large water supply reservoir in an unspoiled valley of the Rocky Mountains.<sup>197</sup> To the Denver Water Board there were no alternatives to this new dam; the Denver region needed more water.<sup>198</sup> To the EPA, however, building a dam answered the wrong question. If the purpose of the project was water supply, that supply could be obtained more efficiently and with less harm through water conservation measures.<sup>199</sup> In part on this ground, the EPA vetoed the permits<sup>200</sup> and Denver has been obliged for the moment to live with the EPA's alternative. Implementing first-stage water conservation measures, average consumer use in the Denver area dropped by nine percent in two years.<sup>201</sup> Denver has since installed water meters in area homes which should save enough water to supply 40,000 new residents. Moreover, in response to an eighty dollar rebate, 12,000 old toilets have been replaced by new low-flush models, each replacement saving at least 4,000 gallons a year.<sup>202</sup>

These results demonstrate how effective the alternatives inquiry can be. They also demonstrate how intrusive it can be (e.g. low-flush toilets), all the more so when the applicant is a local entity or a private party whose range of alternatives are circumscribed by its location. The section 404 program, designed to protect wetlands, deals with nearly 10,000 individu-

---

<sup>197</sup> For a discussion of this controversy, see WILKINSON, *supra* note 109, at 281.

<sup>198</sup> *Id.*; see also *EPA Chief Vetoes Denver Dam*, TIMES-PICAYUNE, Nov. 23, 1990, at A21; Two Forks Dam and Reservoir Project, Application No. Co. 25B OXT 2 008308, Applicant's Practicable Alternative Analysis, 11 (Dec. 7, 1987) (unpublished, on file with the author).

<sup>199</sup> Water Pollution Control; Final Determination of the Assistant Administrator for Water Pursuant to Section 404(c) of the Clean Water Act Concerning the Two Forks Water Supply Impoundments in Jefferson and Douglas Counties, 56 Fed. Reg. 76, 76-77 (Jan. 2, 1991).

<sup>200</sup> *EPA Chief Vetoes Denver Dam*, *supra* note 198, at A21. The veto was also based on high aquatic value of the area affected. *Id.*

<sup>201</sup> *Common Ground*, FRESH WATER NEWS (The Conservation Fund, Arlington, VA) Jan.-Feb. 1993, at 6.

<sup>202</sup> *Id.*



al permit applications a year, the great majority of them small development projects by wetland property owners.<sup>203</sup> Obviously, if a review of alternatives is limited in these cases to accomplishing what the owner has in mind — e.g. filling his or her wetland for an apartment building — there are few meaningful alternatives, the review is moot. On the other hand, if the inquiry is stretched to the utmost this owner could always, as an alternative, go build an apartment in Chicago instead.<sup>204</sup> EPA regulations have attempted to chart a middle course, not limited to the exact wetland or project the applicant has in mind and looking instead at other sites available to the applicant that would serve his or her general purpose, such as in the above case, housing.<sup>205</sup> This is not an easy line to draw, or to hold.<sup>206</sup>

As the Supreme Court has observed, the concept of alternatives is not self-defining.<sup>207</sup> Taking the hint, a more recent appellate decision approved federal funding for an airport that would require that the taking of park land in town A, even though the airport could be located in nearby town B without taking any park land. Town A didn't want to build in

---

<sup>203</sup> STEVE MOYER & J. SCOTT FRIERABEND, STATEMENT OF NAT'L WILDLIFE FED'N BEFORE THE SUBCOMMITTEE ON ENVIRONMENTAL PROTECTION OF THE SENATE ENV'T AND PUBLIC WORKS COMMITTEE ON WETLANDS PROTECTION AND FED. WETLANDS LITIGATION 40 (1992); Oliver A. Houck, *Ending the War: A Strategy to Save America's Coastal Zone*, 47 MD. L. REV. 368, 360-673 (1988).

<sup>204</sup> Oliver A. Houck, *Hard Choices: The Analysis of Alternatives Under Section 404 of the Clean Water Act and Similar Environmental Laws*, 60 U. COLO. L. REV. 773, 835-36 (1989) [hereinafter *Hard Choices*].

<sup>205</sup> See, e.g., 40 C.F.R. §§ 200.3(1), 230.10(a), 230.41-45 (1993); 45 Fed. Reg. 85,336, 85,388 (1980); 44 Fed. Reg. 54,222, 54,234 (1979); 40 Fed. Reg. 794-98 (1975); see also Memorandum from Patrick J. Kelly, Director of Civil Works, to Commander, New Orleans Division, *Permit Elevation, Plantation Landing Resort, Inc.* (Apr. 21, 1989) (unpublished, on file with author).

<sup>206</sup> Robert Uram, *The Evolution of the Practicable Alternatives Test*, 7 NAT. RESOURCES & ENV'T 15, 16-18 (1992). The EPA issued a statement in response to the Plantation Landing, Inc. permit application stating the Corps is not to defer to an applicant's statement of a projects purpose when reviewing an application. A short time later, however, the Corps again accepted the project proponents overall purpose statement and issued a permit for the construction of Old Cutler Bay. *Id.*

<sup>207</sup> *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 551 (1978).

another town and that was that.<sup>208</sup> It seems safe to predict that if agencies are allowed to take the location and nature of development projects as a given in their alternative analyses we will see more highways through parks, more endangered species pushed to the brink and no water conservation programs in cities like Denver. The effect is similar to classifying chlorine-based pulp plants as a separate industrial category for the purposes of BAT. Alternatives disappear, and the concept loses its meaning.<sup>209</sup>

*B. A Practical Problem: Who Wants to Know?*

The alternatives inquiry is further handicapped because it is performed in some cases by people who are not in the best position to discover what alternatives are really available, and in other cases by people who have no interest in finding out. In either case, the inquiry may not produce the desired results.

It should first be noted that alternatives-based requirements generally do not actually require an alternative process method, or an alternative location or design. In pollution control, rather, they require a fixed level of pollution, X parts million of Y, which has been determined to be an achievable level through the examination of alternatives.<sup>210</sup> How an industrial facility subsequently reaches that level is up to each facility to decide. In natural resources law, similarly, the alternatives requirement of section 4(f) does not compel any particular route or means of transportation to avoid taking public park land. Instead, it only determines if alternatives are feasible.<sup>211</sup> The state department of transportation can then

---

<sup>208</sup> *Citizens Against Burlington, Inc. v. Busey* 938 F.2d 190, 198 (D.C. Cir. 1991), *cert. denied*, 112 S. Ct. 616 (1991).

<sup>209</sup> *Id.* at 210 (Buckley, J., dissenting).

<sup>210</sup> *See, e.g.*, 40 C.F.R. § 51.100(i) (1993); *see also* ANDERSON ET AL., *supra* note 10, at 428-32.

<sup>211</sup> *Citizens to Preserve Overton Park, Inc. v. Brinegar*, 494 F.2d 1212, 1216 (6th Cir. 1974), *cert. denied*, 421 U.S. 991 (1975). Strictly speaking, under § 4(f) of the Department of Transportation Act, 49 U.S.C.A. § 1653(f) (West 1976), the Secretary must determine that no alternatives are feasible and prudent before approving federal funding. *Id.*

decide how, alternatively, it wants to proceed. This flexibility noted, the key question is whether alternatives are in fact available and in the resolution of that question the industry, as the state department of transportation, is at best a hostile witness to any proposed change.

In pollution control, be it under the air, water or hazardous waste laws, BAT is developed from the outside in. EPA, often through consultants and contractors, conducts detailed studies of the industry to determine industrial categories and subcategories, and to identify those best-performing processes that should set the norms for "best practicable technology" (BPT) and "best available technology" (BAT) effluent limitations.<sup>212</sup> These results are made available for public review and comments, which is an extensive process that may require dozens of studies and several years, if not decades.<sup>213</sup> Throughout, industry is on the defensive, shooting back: EPA's recommendations are impractical, unproven, too costly or otherwise unavailable.<sup>214</sup> Industry legal challenges are a litany of can't-

---

<sup>212</sup> *E.I. DuPont de Nemours v. Train*, 430 U.S. 112, 121 (1977) (discussing development of effluent limitation guidelines for inorganic chemical industry).

<sup>213</sup> DAVID E. OSBORNE, *REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFERRING THE PUBLIC SECTOR* 300 (1992).

<sup>214</sup> For a discussion of various industry defenses to CWA BAT, see generally ANDERSON ET AL., *supra* note 10, at 428-32. In an attempt to strengthen its hand in negotiations over technical standards for new sources under the Clean Air Act, EPA has adopted a "top-down" approach that examines the best practices in industry first, and requires those opposing it to show why it should not be adopted as BACT; much resisted by industry, this approach has survived, for the moment. *Industry, Local Regulators Voice Concern over EPA Plan to Tighten New Source Review*, [Current Developments] *Env't Rep. (BNA)* No. 50, at 2427 (Apr. 8, 1988); *Reilly Rejects Top-Down BACT Proposal*, [Current Developments] *Env't Rep. (BNA)* No. 39, at 2484 (Jan. 22, 1993). Similarly, in the development of MACT standards for air toxins, Congress has mandated a top percentage of the industry as the standard. See *supra* note 76 and accompanying text.



get-there-from-here.<sup>215</sup> The process is only superficially cooperative; on the inside it more resembles cops-and-robbers.

One result is that the cops do not always win. The attempt to set BAT for the organic chemicals, plastics and synthetic materials category bottomed out, after years of administrative warfare, at a standard no better than BPT.<sup>216</sup> Indeed, EPA concluded by proposing BAT for new sources in this industry, standards intended to be the toughest in the Clean Water Act, without consideration of recycling technologies that had already been adopted by thirty-six plants; twenty-six percent of the industry had already achieved *zero* discharge.<sup>217</sup> These consequences are not unusual; one observer of the process concluded that, while the first-stage BPT inquiry was rigorous, subsequent BAT standards, in general, required little more.<sup>218</sup> Further evidence of the gap between BAT as promulgated and "real BAT" is also illustrated by the experience of whole effluent testing for toxic discharges under the CWA.<sup>219</sup> As a result of "wet" testing, emissions from plants in ostensible compliance with best-possible technology standards have been found toxic

---

<sup>215</sup> *Chemical Mfrs. Ass'n v. EPA*, 870 F.2d 177, 184-85 (5th Cir. 1989), *cert. denied*, 495 U.S. 910 (1990). In that case, the industry raised no fewer than 10 objections to the proposed effluent guidelines, including costs, arbitrariness, unreasonable statistical methodology, effectiveness, technological limitations, uniqueness of plants, unreasonable compliance deadlines, enforcement, poor sampling techniques, and unachievability. *Id.* at 184-85.

<sup>216</sup> *Special Report, Effluent Guidelines Rulemaking Nears End; Litigation, Compliance Extensions Expected*, [Current Developments] *Env't Rep.* (BNA) No. 38, at 1631 (Jan. 21, 1983).

<sup>217</sup> *Chemical Mfrs. Ass'n*, 883 F.2d at 253.

<sup>218</sup> *New BAT Standards: Lowering the Ceiling or Raising the Floor?*, 13 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 10,002, 10,002 (Jan. 1983). The author states:

In the final BAT effluent limitations guidelines, BAT often is the same as best practicable technology (BPT). Where the new BAT is more stringent than BPT, the difference is relatively small and potentially more effective technologies were rejected. On the other hand, some BPT standards in the new rules are based on control technologies too advanced to be considered "practicable" in 1972. It can be argued that EPA has coupled relatively tough BPT with relatively lenient BAT.

*Id.*

<sup>219</sup> 49 *Fed. Reg.* 38,009 (1984) (consolidating permit regulations with biological testing procedures). These regulations were supplemented in 1989 by EPA's final regulations on the *Surface Water Toxics Control Program*, 54 *Fed. Reg.* 23,868 (1989).

to aquatic life, requiring yet further abatement. At which point — Voila! — further abatement proves possible.<sup>220</sup>

Another result is that problems can be simply missed. In the entire process of developing BAT for the pulp and paper industry, for example, no one focused on dioxin, and no alternatives processes were examined to abate dioxin emissions.<sup>221</sup> In the same vein, a recent report by the EPA and Atlantic-Richfield Company reveals that, while ARCO spent millions to comply with EPA air emission requirements, it still failed to control the most significant source of benzene emissions at the facility because benzene was an unregulated pollutant at the time.<sup>222</sup>

A further consequence of outside-in examination of alternatives is that the process identified may not be the most effective or efficient means of reducing the sum total of the various pollutants.<sup>223</sup> Similarly, the system offers no incentive to companies to continue improving their use of initiative to reduce emissions beyond levels prescribed by BAT. These have been the industry's chief arguments against BAT for years,<sup>224</sup>

---

<sup>220</sup> EPA Region VI, Third Round NPDES Permit Implementation Strategy 7-8 (adopted Apr. 1, 1987, revised Oct. 31, 1989) (on file with author); see also Memorandum from Bradley Evens to Oliver A. Houck, Professor of Law at Tulane Univ. (Feb. 10, 1993) (on file with author) (noting as of February 1993, 615 major facilities in EPA Region VI were conducting whole effluent testing of which 108 were also performing toxicity reduction evaluations).

<sup>221</sup> *Water Pollution: Excessive Discharges of Dioxin Confirmed in EPA/Industry Pulp & Paper Mill Study*, [Current Developments] Env't Rep. (BNA) No. 10, at 507 (July 7, 1989); see also *Water Pollution: Little Risk Seen in Dioxin From Paper Mills; Tighter Regulations Expected Anyway, EPA Says*, [Current Developments] Env't Rep. (BNA) No. 1, at 5 (May 4, 1990).

<sup>222</sup> See *A Fresh Start for Environmental Regulations*, *supra* note 1, at 923 (citing this study).

<sup>223</sup> See ANDERSON ET AL., *supra* note 10, at 401-02; *Chemical Mfrs. Ass'n*, 885 F.2d at 1279-80; Bruce Pierre, *Technology-Forcing and Federal Environmental Protection Statutes*, 62 IOWA L. REV. 771, 837 (1977); see also *Pilot Project Cut Pollution at Less Cost than Mandated Rules, AMOCO Official Says*, [Current Developments] Env't Rep. (BNA) No. 24, at 903 (Sept. 24, 1993) (noting recent joint project by EPA and Amoco Oil Company, resulting in significant pollution reductions that cost less to achieve than mandated reductions).

<sup>224</sup> See OSBORNE, *supra* note 213; see also Richard Stewart, *International Trade and Environment: Lessons from the Federal Experience*, 49 WASH. & LEE L. REV. 1329, 1368-71 (1992) (discussing alternative market-based approaches to deal with pollution).

and have led to new flexibility in regulatory progress to allow trade-offs or "bubbles" among discharge sources,<sup>225</sup> and more recently, "markets" in pollution rights.<sup>226</sup> Other proposals are emerging to charge pollution fees for increments beyond BAT, providing an incentive for further reductions.<sup>227</sup> One recent imaginative proposal calls for a "public contract" between industries and regulators requiring a phase out of pollution discharges over fixed periods of time and pollution payments as incentives to reach this goal.<sup>228</sup> In effect, these newer approaches are the industry's counter-offers to EPA-prescribed BAT. They may prove to be workable. In BAT's defense, however, it should be noted that the pressure to make them work, as an alternative to outside-in regulation, is created by the fact of outside-in regulation itself.

Alternatives in natural resources law suffer from almost the opposite answer to the question: who is inquiring? The subject matter here is nowhere near so technical as, for example, possible modifications in the synthetic materials manufacturing process, and the opportunities to avoid harm are not so difficult to identify. A new highway *can* be built around the park; timber sales *can* be offered in tracts not occupied by a spotted owl. On the other hand, the inquiries here are conducted for all but the most critical resources (e.g., wetlands and endangered species) by development agencies (e.g., U.S. Department of Transportation, U.S. Army Corps of Engineers, U.S. Forest Service) that are not inclined to find alternatives to the proposals offered by their state highway, water resources development and timber industry constituencies. Indeed, under section 4(f), the Secretary of Transportation's required findings

---

<sup>225</sup> PERCIVAL, *supra* note 40, at 796-800; *see also* ANDERSON ET AL., *supra* note 10, at 269-74.

<sup>226</sup> David Letson, *Point/Nonpoint Source Pollution Reduction Trading: An Interpretive Study*, 32 NAT. RESOURCES J. 219, 221 (1992); *see* SUSAN ROSE ACKERMAN, *RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE* 128 (1992) (discussing tort law in regulatory state).

<sup>227</sup> Robert Repetto et al., *Green Fees: How a Tax Shift Can Work for the Environment and the Economy*, WORLD RESOURCES INST. REP., Nov. 1992, at 74-76. *See generally* *Hard Choices*, *supra* note 204, at 773-89.

<sup>228</sup> *A Fresh Start for Environmental Regulations*, *supra* note 1, at 923.



of "no feasible and prudent alternative" are routinely drafted, word for word, by state construction agencies and their environmental consultants and presented to the Secretary for signature.<sup>229</sup> These inquiries often falter not because better alternatives are hidden, but because the examiner has no interest in finding them. In these circumstances, short of judicial review, the process fails.

In sum, the alternatives' inquiry is handicapped by the people who conduct it, either way. If done by an outsider, as it is usually done in pollution control laws, it will confront an industry hunkered down behind its ramparts, a wall of engineers, economists and lawyers; it may not find the key. If conducted by an insider, on the other hand, as is usually done in natural resources law, no one is really looking for the key. In both cases, information about alternatives is the enemy, which leads to the next consequence to be discussed.

### *C. A Problem of Fatigue: Can Anyone Stay the Course?*

No environmental decision is easy. Too little is known, and too much is at stake. At least for decisions based on health or biological impacts — however fanciful the supporting science — a decision-maker has the protective cover of the science itself: there will be X deaths per thousand; in Y years the ozone hole will double in size. Alternatives-based decisions provide no such cover. At best, they are in-your-face findings that you should do something another way, usually more costly, usually less convenient and in no case the way you had in mind. These are fighting words, and the ensuing fights are grueling. Over time, simply as a matter of stamina, few agencies will continue to provoke them.

The CWA technology standards provide an illustration of this fatigue. From the outset, Congress viewed BAT develop-

---

<sup>229</sup> For illustration, see the analysis of alternatives prepared by the consultant to the applicant on *Citizens Against Burlington v. Busey*, 938 F.2d 190, 200-01, 208-09 (D.C. Cir. 1991); see also Department of Transportation Regulations, 49 C.F.R. § 520.21(d).

ment as a continuing, dynamic process.<sup>230</sup> A first cut at the best practicable means of pollution control<sup>231</sup> was to be followed by BAT,<sup>232</sup> which levels were to be further reduced by new reviews as new abatement technologies came to light.<sup>233</sup> The early EPA standards took this approach to heart and resulted in discharge levels that closed some operations outright and caused significant process changes in others.<sup>234</sup> However, the scope of the endeavor was enormous. The EPA's review of dozens of industrial categories, covering dozens of pollutants, hundreds of processes and affecting thousands of individual plants, was subject to intense lobbying from trade associations on the one hand and environmental organizations on the other. Each review was a prelude to litigation, frequent remands and the renewal of new rounds of battle.<sup>235</sup> One lawsuit challeng-

---

<sup>230</sup> Pub. L. No. 92-500, 1972 U.S.C.A.N. (86 Stat.) 3668.

The Administrator will have the capability and the mandate to press technology and economics to achieve those levels of effluent reduction which he believes to be practicable in the first instance and attainable in the second. . . . [T]he program established by this section requires increasingly tougher controls on industry; . . . industry will be required every five years to re-evaluate its control efforts and to apply the best technology then available; . . . industries will have to show every five years that no-discharge is not attainable . . . .

*Id.* at 3709; see also ROGERS, *supra* note 23, at 29-30.

<sup>231</sup> 33 U.S.C.A. § 1314(b)(1)(B). The CWA predicated best practicable technology (BPT) on a comparison of "the total cost of application" and the consideration of other factors. *Id.*

<sup>232</sup> *Id.* § 1314(b)(2)(B). Best available technology (BAT) required the consideration of costs. *Id.* But no cost-benefit comparison sets the stage for considerably more stringent limitations. *Id.*; see also *Weyerhaeuser Co.*, 590 F.2d at 1017-18 (discussing EPA's variance clause for regulations). BPT was to be achieved by 1977 and BAT by 1983. 33 U.S.C.A. § 1311(b)(1)(A), (b)(2)(A).

<sup>233</sup> 33 U.S.C.A. § 1311(b)(1)(A), (b)(2)(A).

<sup>234</sup> See *Association of Pac. Fisheries v. EPA*, 615 F.2d 794, 818 (9th Cir. 1980).

<sup>235</sup> Industry challenges to technology standards include: *Armco, Inc. v. EPA*, 869 F.2d 975 (6th Cir. 1989) (steel industry); *American Petroleum Inst. v. EPA*, 858 F.2d 261 (5th Cir. 1988) (oil and gas industry); *Texas Mun. Power Agency v. EPA*, 836 F.2d 1482 (5th Cir. 1988) (electric utility industry); *American Petroleum Inst. v. EPA*, 787 F.2d 965 (5th Cir. 1986) (oil and gas industry); *Kennecott v. EPA*, 780 F.2d 445 (4th Cir. 1985) (nonferrous metals manufacturing industry), *cert. denied*, 479 U.S. 814 (1986); *Cerro Copper Prod. Co. v. Ruckelshaus*, 766 F.2d 1060 (7th Cir. 1985) (copper forming industry); *Reynolds Metals Co. v. EPA*, 760 F.2d 5459 (4th Cir. 1985) (metal and brewing industries); *National Ass'n of Metal Finishers v. EPA*, 719 F.2d 624 (3d Cir.

ing BAT for one industrial category alone produced a 600,000 page administrative record, seventy legal claims, over 3,000 pages of briefs and a 9,000 page joint appendix.<sup>236</sup> Twenty years after the CWA gave marching orders for BAT, EPA was still trying to promulgate these standards for industries as significant as offshore oil and gas production,<sup>237</sup> pesticide manufacture,<sup>238</sup> and plastics and organic chemicals.<sup>239</sup>

In 1988, Congress directed an obviously weary EPA to finish the job for unregulated categories, and then, to go back

---

1983) (electroplating industry), *rev'd on other grounds*, Chemical Mfrs. Ass'n v. NMRDC, 470 U.S. 116 (1985); American Petroleum Inst. v. EPA, 661 F.2d 340 (5th Cir. 1981) (oil and gas industry); American Paper Inst. v. EPA, 660 F.2d 954 (4th Cir. 1981) (paper industry); Association of Pac. Fisheries v. EPA, 615 F.2d 794 (9th Cir. 1980) (seafood processing industry); BASF Wyandotte Corp. v. Costle, 598 F.2d 637 (1st Cir. 1979) (organic pesticide industry), *cert. denied*, 444 U.S. 1096 (1980), *modified*, 614 F.2d 21 (1st Cir. 1980); Weyerhaeuser Co. v. Costle, 590 F.2d 1011 (D.C. Cir. 1978) (pulp and paper industry); American Iron & Steel Inst. v. EPA, 568 F.2d 284 (3d Cir. 1977) (iron and steel industry); Marathon Oil Co. v. EPA, 564 F.2d 1253 (9th Cir. 1977) (oil and gas industry); American Paper Inst. v. Train, 543 F.2d 328 (D.C. Cir. 1976) (pulp and paper industry); E.I. DuPont de Nemours & Co. v. Train, 541 F.2d 1018 (4th Cir. 1976) (inorganic chemical manufacturing industry), *rev'd on other grounds*, 430 U.S. 112 (1977); Tanners' Council of Am., Inc. v. Train, 540 F.2d 1188 (4th Cir. 1976) (leather tanning industry); American Petroleum Inst. v. EPA, 540 F.2d 1023 (10th Cir. 1976) (oil and gas industry), *cert. denied*, 430 U.S. 922 (1977); FMC Corp. v. Train, 539 F.2d 973 (4th Cir. 1976) (plastic and synthetic materials industries); American Frozen Food Inst. v. Train, 539 F.2d 107 (D.C. Cir. 1976) (frozen potato products); Hooker Chem. & Plastics Corp. v. Train, 537 F.2d 620 (2d Cir. 1976) (phosphorous manufacturing); American Iron & Steel v. EPA, 526 F.2d 1027 (3d Cir. 1975), *modified*, 560 F.2d 589 (3d Cir. 1977) (iron and steel industry), *cert. denied*, 435 U.S. 915 (1978); American Meat Inst. v. EPA, 526 F.2d 442 (7th Cir. 1975) (meat products industry); CPC Int'l, Inc. v. Train, 515 F.2d 1032 (8th Cir. 1975) (corn wet milling industry); Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375 (D.C. Cir. 1973) (cement manufacturing industry), *cert. denied*, 417 U.S. 921 (1977).

<sup>236</sup> *Chemical Mfrs. Ass'n*, 870 F.2d at 184.

<sup>237</sup> 58 Fed. Reg. 49,126 (1993).

<sup>238</sup> See *Final Pesticide Rule Sets Effluent Guidelines, Leaves 1992 Proposal Intact*, EPA Official Says, [Current Developments] Env't Rep. (BNA) No. 24, at 875 (Sept. 17, 1993).

<sup>239</sup> *Chemical Mfrs. Ass'n*, 885 F.2d at 1277. Compounding this delay, EPA's battles to establish MACT for more than 100 sources of toxic pollutants under the Clean Air Act are just beginning. 56 Fed. Reg. 28,548-57 (1991). See generally William A. Wichers, II et al., *Regulations of Hazardous Air Pollutants Under the New Clean Air Act: Technology Based Standards at Law*, 22 Env'tl. L. Rep. (Env'tl. L. Inst.) 10,717 (Nov. 1992).



and upgrade its original standards through a new round of reviews.<sup>240</sup> EPA has been slow to respond and has been sued for its slowness. The process grudgingly inches forward.<sup>241</sup> This brings us to something of a paradox: BAT standards have produced marked reductions in water pollution, all the more marked when compared to water quality and health-based approaches, and have the potential to produce much more (particularly so for those industries whose BAT still equals BPT, if it exists at all). The agency responsible, on the other hand, has no heart for the struggle, which could take another twenty years. All of which helps explain EPA's enthusiasm in recent years for voluntary reductions,<sup>242</sup> pollution prevention,<sup>243</sup> market systems<sup>244</sup> and even state-based water quality standards.<sup>245</sup> Anything but more BAT.

If the alternatives inquiry is difficult in the development of pollution control standards, there is at least a common understanding of its framework and its focus: what alternative technologies are available and what reductions will they accomplish? In natural resources law, by contrast, a decision-maker is called upon to tell an applicant to go elsewhere or to do something different. They are chafed on one side by opponents who don't want the activity anywhere and on the other by those who want the benefits of the project at whatever environmental cost. At the bottom, the arguments are neither technical nor based on objective evidence; they are formless and unpleasant. Oregon's Director of Land Conservation and

---

<sup>240</sup> 33 U.S.C. § 1314(m). See generally *The Regulation of Toxic Pollutants*, *supra* note 31, at 10,528.

<sup>241</sup> *The Regulation of Toxic Pollutants*, *supra* note 31, at 10,540-41.

<sup>242</sup> *More than 600 Firms Asked to Reduce Releases of 17 Toxic Chemicals Voluntarily*, [Current Developments] *Env't Rep. (BNA)* No. 21, at 1838 (Feb. 15, 1991); see also *Reilly's Corporate Volunteerism Campaign Marred by Skepticism*, [Current Developments] *Env't Rep. (BNA)* No. 22, at 2682 (Apr. 3, 1992).

<sup>243</sup> EPA Pollution Prevention Strategy, 56 Fed. Reg. 7,849.

<sup>244</sup> Letson, *supra* note 226, at 231.

<sup>245</sup> Special report quoting Steven Schatzow, Director of EPA's Office of Water Regulations and Standards, saying that since "the technology is available," EPA need not require it; rather the "states can require it to protect water quality." EPA, *QUALITY CRITERIA FOR WATER*, *supra* note 29, at 116-19; (1976); see also *The Regulation of Toxic Pollutants*, *supra* note 31, at 10,541-42 (statements of Rebecca Hanmer).

Development has called the task "a tough, nasty business."<sup>246</sup> Yet, in order to protect the nation's wetlands, the Corps of Engineers is engaged in this business more than 10,000 times a year.<sup>247</sup> EPA is pressed to its limits to defend a section 404 veto, and it is no surprise that it has exercised this authority only eleven times in the last twenty years.<sup>248</sup> The Departments of Interior and Commerce, federal custodians of endangered species, are equally circumspect in their findings of "jeopardy" under section 7 of the ESA,<sup>249</sup> and tolerant to the point of dereliction in their identification of jeopardy-avoiding alternatives that have allowed construction projects to proceed which impact endangered species.<sup>250</sup> The Bureau of Land Manage-

---

<sup>246</sup> *Efforts to Combat Marine Pollution Not Keeping Pace With Growth, State Group Told*, [Current Developments] Env't Rep. (BNA) No. 18, at 1934-35 (Dec. 18, 1987) (statement of Jim Ross, Director of Oregon Dep't of Land Conservation and Development).

<sup>247</sup> See *supra* notes 153-162 and accompanying text; see also *Hard Choices*, *supra* note 204, at 787.

<sup>248</sup> The first constraint is the statute itself, which predicates the vetoes on "unacceptable adverse effects." 33 U.S.C.A. § 1344(c). The EPA has been understandably cautious in expanding this authority from impacts to the larger view of alternatives. The second constraint is logistical, for each of these determinations reflects an extraordinary commitment of person-years and resources that no EPA region can maintain on more than one permit, perhaps two, at any one time. The last constraint is tactical, and relates to EPA's particular expertise, which is, after all, in aquatic resources and not in the real estate market, engineering, or private development. It is the prudent course for EPA, at the veto stage, to keep its determinations within the arena of that acknowledged expertise which opponents will be least able to attack, and to which course will be most likely to defer. See *Hard Choices*, *supra* note 204, at 794. "The section 404(c) process sets of an administrative chain of appeals, defenses, adjudicatory hearings, and judicial review similar in some respects to the cancellation of a pesticide, a process so daunting it is seldom launched." *Id.* at 829.

<sup>249</sup> UNITED STATES GENERAL ACCOUNTING OFFICE, ENDANGERED SPECIES ACT: TYPES AND NUMBER OF IMPLEMENTING ACTIONS (1992) (implementing data from listing to recovery); see also WORLD WILDLIFE FUND, THE CONSERVING LISTED SPECIES TALK IS CHEAPER THAN WE THINK: THE CONSULTATION PROCESS UNDER THE ENDANGERED SPECIES ACT (1992) (data on consultation, jeopardy findings and alternatives).

<sup>250</sup> See analysis of 99 United States Fish and Wildlife Service biological opinions, between 1987 and 1992, identifying "reasonable and prudent alternatives" to avoid jeopardy under the ESA in *The Endangered Species*, *supra* note 171, § II, App. I. See in particular the discussion on Highway 53 between Trego and Hawthorne, which allowed construction of a federal-aid highway through habitat of the endangered eastern timberwolf; and consequently, the "reasonable and prudent alternative" being a wider median strip to avoid impacts on the only known dispersal route for wolves across the

ment is finding it no easier to propose alternatives that would reduce federal grazing allotments.<sup>251</sup> Moreover, the United States Forest Service is not finding it easy to reduce historic, if unsustainable, levels of timber harvest.<sup>252</sup> Department of Transportation section 4(f) findings of "no reasonable and prudent alternative" are rare as hen's teeth,<sup>253</sup> as are NOAA's findings of "inconsistency" with state coastal management plans.<sup>254</sup> In all of these decisions, the alternatives' inquiry is dealing with a "right to-do-what-we-want" psyche that we have largely shed for decisions on industrial processes, but that remains ingrained for what we otherwise do to the land.

None of which is to say that "natural resource BAT" has, after all, proven irrelevant. On the contrary, it has worked wonders to work the changes that it has, as a rarely used presence, the gorilla-in-the-closet of natural resource law. The

---

state. *The Endangered Species*, *supra* note 171, at 320 n.282.

<sup>251</sup> John Lancaster, *Public Land, Private Profit*, WASH. POST, Feb. 17, 1991, at A1; see Duerk, *BLM Manager in Wyoming Gets Trampled*, HIGH COUNTRY NEWS, Feb. 22, 1993, at 3; Florence Williams, *National Forest Grazing Cuts are Stalled by Politics*, HIGH COUNTRY NEWS, June 1, 1992, at 1.

<sup>252</sup> Margaret E. Kriz, *Last Stand on Timber*, NAT'L J., Mar. 3, 1990, at 512.

<sup>253</sup> C. Olsen, *Overton Park Revisited 2* (1987) (an unpublished manuscript on file with author) which states:

It is possible that there has [sic] been better than three thousand (3,000) Section 4(f) statements prepared over the last twenty (20) years. Of that sum, the number of Section 4(f) statements prepared for park/recreation area takings was approximately eighteen hundred (1,800) which represents about sixty (60%) of all Section 4(f) takings during the same time period. Of the eighteen hundred (1,800) or so possible park/recreation area takings, I was only able to identify about fifty (50) reported district and appellate court decisions which addressed those actions. Of the fifty (50) or so reported cases, the United States Department of Transportation was faced with remand on only ten (10) or so occasions, and finally, of the ten (10) or so remands, it is very possible that only one (1) park was ever totally saved. Welcome to Overton Park.

*Id.*

<sup>254</sup> See generally Oliver A. Houck, *Land Loss in Coastal Louisiana: Causes, Consequences, and Remedies*, 58 TUL. L. REV. 3, 148 (1983) (underlying and fueling recent controversy over federal regulatory program in Louisiana has been perception of state program itself); Michael E. Coney, *A Review of the Coastal Zone Consistency Appeal Process for Oil and Gas Activities on the Outer Continental Shelf* (1993) (unpublished manuscript on file with author).



possibility of a federal veto steers development away from sensitive areas *ab initio*; few developers today will go looking for wetland real estate or endangered species habitat. We will never know how many federal-aid highways were *not* proposed to be located through parks because of section 4(f). The strength of these provisions further provide important leverage in the inevitable bargaining sessions through which natural resources decisions are ultimately made.<sup>255</sup> We arrive at trade-offs. We are also forced by the excruciating pressure of the exercise to search for new ways of protecting these areas short of simply commanding an alternative location. Among the more promising of these approaches are the creation of credits for restoring rare ecosystems<sup>256</sup> and the development of markets analogous to those market approaches that are emerging in pollution control law in those credits for future development.<sup>257</sup> All of this said, examining alternatives and compelling their selection, either for industrial processes or for

---

<sup>255</sup> *National Wildlife Fed'n v. Coleman*, 529 F.2d 359, 361 (5th Cir. 1976) (accommodating contested interchange on interstate 10 north of Biloxi, Mississippi by acquiring adjacent lands for refuge protecting Mississippi Sandhill Crane); Buddy Fynum, *Sand Hill Crane Reserve Bought*, THE SUN HERALD (Biloxi, Miss.), Nov. 2, 1974 at A1; *Wildlife Service Orders I-10 Construction Halt*, THE SUN HERALD (Biloxi, Miss.), Nov. 2, 1974, at A1; see also James C. Kilbourne, *The Endangered Species Act Under the Microscope: A Closeup Look from a Litigator's Perspective*, 21 ENVTL. L. 499, 563 n.305 (1991) (approving exemption for Grayrocks Dam with conditions to ensure adequate water to avoid jeopardy for endangered Whooping Crane, in essence compromise allowing dam to go forward).

<sup>256</sup> A current favorite is "mitigation banking," allowing credits for wetlands restoration to permit wetlands destruction. For a review of the successes, failures and difficulties with this approach, see William J. Haynes II & Royal C. Gardner, *The Value of Wetlands as Wetlands: The Case for Mitigation Banking*, 23 ENVTL. L. Rep. (Envtl. L. Inst.) 10,261 (May, 1993) (reviewing successes, failures and difficulties with this approach).

<sup>257</sup> Similar to "mitigation banking" under § 404 of the CWA, § 9 of the ESA involving habitat conservation planning, is creating a potential new industry to restore endangered species habitat. See Todd G. Olsen & Dennis M. Moser, *The Habitat Transaction Method of Conservation Planning, Land Acquisition and Funding* (June 10, 1992) (unpublished manuscript, on file with the author); see also Todd G. Olson et al., *The Habitat Transaction Method: A Proposal for Creating Tradeable Credits in Endangered Species Habitat*, in BUILDING ECONOMIC INCENTIVES INTO THE ENDANGERED SPECIES ACT 27, 27-36 (Wendy E. Hudson ed.) (Defenders of Wildlife 1993).

other development decisions, remains the toughest business in environmental law. The pressure mounts to find an easier way.

*D. A Problem in the Courts: Can Alternatives Tests Survive Judicial Review?*

American environmental law relies on judicial review. Industry has challenged virtually every regulation the EPA has issued under the CAA, CWA and RCRA.<sup>258</sup> These actions may well have resulted in more feasible abatement requirements. Also, they have delayed these programs for years, in some cases for decades, leading some observers to conclude that Congress would have done better to simply set standards, however arbitrarily, by statute.<sup>259</sup> At the same time, other lawsuits brought by citizen groups, and not infrequently by affected states, have accelerated the pace of these programs,<sup>260</sup> broadened their scope<sup>261</sup> and tightened their requirements.<sup>262</sup> This tug-of-war is familiar to any student of environmental law. No issue of any importance is settled until the courts have ruled. In general, although subject to many qualifications, courts have been favorable towards alternatives-based requirements in pollution control law. Their treatment of alternatives in natural resource law is more mixed, and lately, antagonistic.

Using again the CWA as an example, early court decisions allowed EPA great leeway in developing BAT standards. The courts approved the promulgation of standards on an expedited

---

<sup>258</sup> See *supra* note 235.

<sup>259</sup> See Shoenbrod, *supra* note 67.

<sup>260</sup> For example, Natural Resource Defense Council, Inc. lawsuits resulted in settlements which placed the EPA under deadlines for promulgating pretreatment standards. See *Natural Resource Defense Council, Inc. v. Train*, 6 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,588, 20,589 (D.D.C. June 9), *modified sub nom.*, *Natural Resource Defense Council, Inc. v. Costle*, 9 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,176, 20,177 (D.D.C. Nov. 9, 1979), *aff'd sub nom.*, *Environmental Defense Fund, Inc. v. Costle*, 636 F.2d 1229 (D.C. Cir. 1980).

<sup>261</sup> *Natural Resource Defense Council, Inc. v. Callaway*, 392 F. Supp. 685, 686 (D.D.C. 1975).

<sup>262</sup> *Natural Resource Defense Council, Inc. v. EPA*, 824 F.2d 1146, 1152-54 (D.C. Cir. 1987).

basis,<sup>263</sup> cost-benefit calculations,<sup>264</sup> demonstrable water quality improvements,<sup>265</sup> or provisions for upsets or other foreseeable and unavoidable violations.<sup>266</sup> Moreover, this standards promulgation was approved on a broad scope of alternatives that anticipated inter-industry transfer of technology,<sup>267</sup> technologies not in use in the United States,<sup>268</sup> even purely hypothetical models,<sup>269</sup> and with results that would close significant percentages of the affected industries.<sup>270</sup> With this momentum, the Act departed from the rut of its predecessors and resulted in numerical standards, permit limitations and measurable abatement.<sup>271</sup> In more recent times, however, when the organic chemicals, plastics and synthetic fibers industries challenged the EPA's BAT, the U.S. Court of Appeals for the Fifth Circuit eventually split the baby by affirming the EPA's approach in the main,<sup>272</sup> but tossing significant relief to one subcategory of the industry<sup>273</sup> and other smaller relief to the environmental side.<sup>274</sup> Other Fifth Circuit cases in recent years have invalidated the EPA's BAT for oil and gas industry discharges<sup>275</sup> and approved EPA delay in the promulgation of new standards.<sup>276</sup> Judges, no less than agencies, tire of cracking the whip.

---

<sup>263</sup> *E.I. DuPont de Nemours & Co.*, 541 F.2d at 1027.

<sup>264</sup> *Weyerhaeuser Co.*, 590 F.2d at 1036-37.

<sup>265</sup> *Association of Pac. Fisheries*, 615 F.2d at 812.

<sup>266</sup> *Corn Refiners Ass'n v. Costle*, 594 F.2d 1123, 1125-26 (8th Cir. 1979).

<sup>267</sup> *Kennecott v. EPA*, 780 F.2d 445, 453-54 (4th Cir. 1985), *cert. denied*, 479 U.S. 814 (1986).

<sup>268</sup> *American Frozen Food Inst. v. Train*, 539 F.2d 107, 132 (D.C. Cir. 1976).

<sup>269</sup> *CPC Int'l, Inc. v. Train*, 540 F.2d 1329, 1341-42 (8th Cir. 1976), *cert. denied*, 430 U.S. 966 (1977).

<sup>270</sup> *Association of Pac. Fisheries*, 615 F.2d at 920.

<sup>271</sup> EPA, REPORT TO CONGRESS: WATER QUALITY IMPROVEMENT STUDY (Sept. 1989). In this report, the EPA found a 29% improvement in water quality compliance when BAT regulations are imposed compared with pre-BAT standards. *Id.*

<sup>272</sup> *Chemical Mfrs. Ass'n*, 870 F.2d at 198.

<sup>273</sup> *Chemical Mfrs. Ass'n*, 885 F.2d at 260-65.

<sup>274</sup> *Chemical Mfrs. Ass'n*, 870 F.2d at 198.

<sup>275</sup> *American Petroleum Inst. v. EPA*, 661 F.2d 340, 356-57 (5th Cir. 1981).

<sup>276</sup> *Natural Resource Defense Council, Inc. v. EPA*, 863 F.2d 1420, 1427-28 (9th Cir. 1988).



Courts have been equally instrumental but even more ambiguous in enforcing the alternatives requirements of natural resources statutes. Case law under NEPA, section 4(f) of the Department of Transportation Act, section 404 of the CWA and section 7 of the Endangered Species Act shows two lines of thinking that, when placed side by side, are nearly impossible to reconcile.<sup>277</sup> Those opinions that seek to vindicate the protective purposes of these statutes, taking their lead from *Citizens to Preserve Overton Park, Inc. v. Volpe*<sup>278</sup> and *Calvert Cliffs' Coordinating Committee, Inc. v. United States Atomic Energy Commission*,<sup>279</sup> require a very "hard look" at the consideration of alternatives and reversal of decision where the consideration was superficial or the agency's conclusions were unsupported by fact. In the other camp are an equally impressive number of opinions, among them *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*,<sup>280</sup> that shrink the scope of the alternatives review required and take at face value whatever official reasons are offered for finding no alternatives available. Cases in both veins arise under section 4(f) of the DOT Act, whose overriding purpose is to protect parks and whose applicability to a narrow range of transportation projects and alternatives requirements are as clear as Congress could draft them.<sup>281</sup> Equally schizoid are the alternatives cases arising under section 404 of the CWA,<sup>282</sup> and in

---

<sup>277</sup> For a more detailed discussion of these lines of cases, see *Hard Choices*, *supra* note 204, at 813-26.

<sup>278</sup> 401 U.S. 402 (1971).

<sup>279</sup> 449 F.2d 1109 (D.C. Cir. 1971).

<sup>280</sup> 435 U.S. 519 (1978).

<sup>281</sup> *Compare* Stop H-3 Ass'n v. Dole, 740 F.2d 1442, 1451 (9th Cir. 1984) (holding alternative that would displace church, four businesses and 31 homes, increase noise pollution levels and require construction of additional \$42 million viaduct should not be discounted as not "prudent"), *cert. denied*, 471 U.S. 1108 (1985) *with* Eagle Found. v. Dole, 813 F. 2d 798, 808 (7th Cir. 1987) (holding far less disruptive alternative discounted as not "prudent").

<sup>282</sup> *Compare* Deltona Corp. v. United States, 657 F.2d 1184, 190-92 (Ct. Cl. 1981) (denying dredge and fill permit to residential developer), *cert. denied*, 455 U.S. 1017 (1982) *and* Buttrey v. United States Army Corps of Engineers, 690 F.2d 1170, 1172-73 (5th Cir. 1982) (denying residential developer permit to channelize portion of stream), *with* 1902 Atlantic Ltd. v. Hudson, 574 F. Supp. 1381, 1407 (E.D. Va. 1983) (holding

particular those rare instances in which EPA has exercised its authority to veto a permit for wetland development because an alternatives site or method was available. While the United States Court of Appeals for the Second Circuit supported the EPA's veto of a shopping mall in Massachusetts for example,<sup>283</sup> a district court in Norfolk has twice overturned an EPA veto of a water supply reservoir,<sup>284</sup> and the EPA's similar veto of the proposed Two Forks Dam is likewise on appeal.<sup>285</sup>

At bottom, whether they arise under the NEPA or a statute with a more substantive alternatives requirements, natural resources cases have political overtones that tend to daunt reviewing courts as they do agency decision-makers. These actions are not limited to the question of whether the EPA adequately evaluated Y technology; they involve struggles between miners and ranchers, city councils and neighborhood associations, real estate developers and environmentalists, . . . to name but a few of the actors . . . and a court decision that an alternative is "available" is tantamount to a decision that a project long on the drawing boards, at last ready to proceed, may not go forward as planned. However specific the language of the statute and whatever the obligation of courts to uphold the law, it is a rare judge who will make such a call.

These same dynamics are behind two other recent developments that threaten to make the alternatives approach less effective in the future, particularly in natural resources law. One development is the resurgence of "standing" requirements that may leave agencies unsupervised by anyone other than the

---

Corps denial of permit to fill burrow pit as arbitrary, capricious, abuse of discretion and otherwise not consistent with applicable laws), and *National Audubon Soc'y v. Hartz Mountain Dev. Corp.*, 14 *Envtl. L. Rep. (Envtl. L. Inst.)* 20,724, 20,729 (D.N.J. Oct. 24, 1983) (sustaining Corps decision to grant commercial developer permit to fill wetlands).

<sup>283</sup> *Bersani*, 674 F. Supp. at 420 (sustaining EPA decision that resultant damage to wetlands and wildlife from proposed shopping mall was unacceptable).

<sup>284</sup> *James City County v. EPA*, 758 F. Supp. 348, 353 (E.D. Va. 1990), *aff'd*, 955 F.2d 254 (4th Cir. 1992).

<sup>285</sup> *Alameda Water and Sanitation Dist. v. Browner*, No. 91-M-2047 (D.C. Colo. filed June 21, 1993).

economic interests who stand to benefit from their decisions.<sup>286</sup> The other is the resurgence of "takings" jurisprudence, led by the Supreme Court and the United States Court of Claims, that will freight at least some decisions requiring alternatives with a steep new price tag.<sup>287</sup>

Environmental decisions setting pollution standards or approving development plans are the last step in a tug-of-war that only begins with the enabling legislation, and continues at high heat through the promulgation of regulations and their application to particular industries and projects.<sup>288</sup> In this process, agencies find themselves torn between trade associations and environmental organizations. At the same time, they find themselves informed by these groups, and their final decisions strike an equitable balance between the competing interests.<sup>289</sup> For instance, the CWA's regulations and BAT standards were forged out of the competing views of the affected industries and a single environmental group, the Natural Resources Defense Council.<sup>290</sup> Agencies have to listen to both

---

<sup>286</sup> The law of "standing" serves to determine who may litigate a claim in the federal courts. See *Association of Data Processing Serv. Orgs., Inc. v. Camp*, 397 U.S. 150, 151-52 (1970). Originally derived from the constitutional requirement that federal courts adjudicate a "case or controversy," the concept has been broadened in recent years to include "jurisprudential" considerations as well. See *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 38-39 (1976). See generally KENNETH T. DAVIS, *ADMINISTRATIVE LAW TEXT* §§ 22.01-22.08 (3d ed. 1972) (discussing law of standing).

<sup>287</sup> The law of "takings" derives from the Constitutional requirement that private property not be taken for public use without "just compensation." U.S. CONST. amend. Originally restricted to physical takings, the Supreme Court has expanded the concept to takings by regulation as well. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

<sup>288</sup> Al Kamen, *Despite Bill's Signing, Fight Has Just Begun*, WASH. POST, Nov. 22 1991, at A14.

<sup>289</sup> The recognition of this fact has led to an innovation in environmental rulemaking called "negotiated rulemaking," in which the warring parties sit in the same room and attempt to arrive at a compromise. *Regulatory Negotiations: A Practical Perspective*, 22 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 10,647 (Oct. 1992).

<sup>290</sup> See *Rybachek v. EPA*, 904 F.2d 1276, 1283-84 (9th Cir. 1990) (discussing rule-making process mining regulations); *Chemical Mfrs. Ass'n*, 870 F.2d at 216-17 (challenging EPA regulations regarding plant treatment systems); *Natural Resource Defense Council, Inc. v. EPA*, 863 F.2d 1420, 1427-28 (9th Cir. 1988) (discussing oil and gas discharge regulations); *Natural Resource Defense Council, Inc. v. EPA*, 859 F.2d 156, 177-78 (D.C. Cir. 1988) (discussing National Pollution Discharge Elimination



sides in this process for one simple reason: either side can take them to court.<sup>291</sup> One side, and often both, usually does. The Court's role is not to re-decide the merits but to ensure that the factors required by law — including alternatives, where relevant — were properly considered.<sup>292</sup> Courts keep the system honest. Judicial review is one reason American environmental law works, and the quite similar laws of other countries do not.

The predicate for judicial review is, of course, access to the courts. If one side in this process is denied access, there is no reason that its views need to be considered in agency decision-making on BAT, RACT, MACT or the location of a highway through Overton Park. The tug-of-war only pulls one way.

In recent years the Supreme Court has begun to deny access to the courts by members of the public and, in particular, environmentalists. In *Lujan v. National Wildlife Federation*,<sup>293</sup> the Court required, as a condition of access to the courts, proof of injury so particular as to enable government agencies to ignore the law broadly and escape judicial review on all but isolated, individual cases.<sup>294</sup> In the more recent *Lujan v. Defenders of Wildlife*,<sup>295</sup> the Court required injury so specific that an affidavit of a scientist that she had visited the project site in connection with her work and intended to revisit it was insufficient to allow her to question the project's compliance with the Endangered Species Act,<sup>296</sup> as the majority explained, there was civil unrest in the area and the scientist had no fixed commitments for her return trip.<sup>297</sup> In dissent, Justice

---

System permit regulations); *Natural Resource Defense Council, Inc. v. EPA*, 822 F.2d 104, 115-16 (D.C. Cir. 1987) (analyzing best available technology and zero discharge goals); *Natural Resource Defense Council, Inc. v. Train*, 510 F.2d 692, 706-11 (D.C. Cir. 1975) (discussing toxic pollutant regulations).

<sup>291</sup> 33 U.S.C.A. §§ 1319, 1369; 42 U.S.C.A. §§ 7604, 7607.

<sup>292</sup> *Citizens to Preserve Overton Park, Inc.*, 401 U.S. at 415-16.

<sup>293</sup> 497 U.S. 871 (1990).

<sup>294</sup> *Lujan*, 497 U.S. at 889; see *Conservation Law Found. of New England, Inc. v. Reilly*, 950 F.2d 38, 41-43 (1st Cir. 1991) (stating that environmental organization had no standing to challenge federal waste practices at 840 locations around country).

<sup>295</sup> 112 S. Ct. 2130 (1992).

<sup>296</sup> *Lujan*, 112 S. Ct. at 2138.

<sup>297</sup> *Id.*

Blackmun characterized this narrowing of access to the courts as "a slash and burn expedition through administrative environmental law."<sup>298</sup> As Justice Scalia, in the majority has written elsewhere, however, if this new line of jurisprudence means that litigants are "lost in the vast hallways of the bureaucracy,"<sup>299</sup> so be it; environmental laws will not receive judicial review.<sup>300</sup>

Whether the majority's view reflects a simple hostility to environmental legislation or a more complex view of the Constitution, the consequences of these cases are indisputable. First, economic interests remain empowered while environmental interests and the rest of the public drop out, and with them, adherence to the alternatives standard. The second consequence is that the Supreme Court has gone as far as it can to make the first irreversible by deriving it, not from statutes or even from "jurisprudential" considerations, but, rather, from the Constitutional requirement that federal lawsuits present a "case or controversy." That suit brought, for example, by the National Wildlife Federation alleging that certain construction projects violates the Endangered Species Act will be so inchoate as to not constitute a "case," or so poorly litigated as not to present a "genuine controversy," is almost beyond reason: one suspects that the reason for denying environmental standing in these cases is that they will be well litigated indeed and will have a very "choate" effect on someone's preconceived development plan. Once placed on Constitutional ground, however, the Court's conclusions are beyond review. Even the CWA and the CAA's specific reliance on citizen lawsuits to ensure that their pollution standards conform to the requirements of the Act are vulnerable to a finding that, whatever Natural Resource Defense Council's interest or expertise, it has no standing as a matter of Constitutional law. We are left with a decision-making process in which the alternatives-limiting side comes

---

<sup>298</sup> *Id.* at 2160.

<sup>299</sup> Antonin M. Scalia, *The Doctrine of Standing as an Essential Element of the Separation of Powers*, 17 SUFFOLK U. L. REV. 881, 897 (1983).

<sup>300</sup> *Id.*

armed with the right of reprisal and the other with a beggar's pan.

In another line of cases, equally new and ripe for expansion, the Court has moved to make the consequences of alternatives-based environmental decision-making costly where private ownership is at stake. The Court's new attention to "takings" jurisprudence arises from a series of land use decisions with which the Court felt little sympathy.<sup>301</sup> In its most recent utterance, *Lucas v. South Carolina Coastal Commission*,<sup>302</sup> the Court considered a state law prohibiting new development on coastal property so fluctuating in elevation and so vulnerable to flooding that it had been below sea level for forty out of the last eighty years.<sup>303</sup> The court rejected the idea that the inevitable flood losses and destruction of public resources caused by development on this terrain would be a public nuisance and remanded the case with something resembling a directed verdict of a taking.<sup>304</sup> The first impact of these cases has been to set off a feeding frenzy of lawsuits claiming takings because of section 404 permit denials and limitations, which is stimulated by favorable rulings and sizeable judgments from the U.S. Court of Claims.<sup>305</sup> Lawsuits have also been filed claiming takings by the designation of

---

<sup>301</sup> *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 838-42 (1987) (Brennan, J., dissenting). The dispute in *Nollan* centered around the placement of petitioner's beach-front residence. *Id.* at 827-31 (Brennan, J., dissenting). The Court invalidated a California agency's requirement that waterfront housing construction be accompanied by a provision of public right of way. *Id.* at 838-39 (Brennan, J., dissenting). The language of the *Nollan* majority was so hostile that it was remarked upon by the dissent. *Id.* at 846 (Brennan, J., dissenting); see also *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 314-22 (1987) (finding even temporary ordinance preventing new structures in area recently subject to severe flooding, pending new regulations, could be a "taking" and require government compensation), *cert. denied*, 493 U.S. 1056 (1990).

<sup>302</sup> 112 S. Ct. 2886 (1992).

<sup>303</sup> See Rutherford H. Platt, *An Eroding Base*, THE ENVTL. FORUM, Sept.-Oct., 1992, at 10.

<sup>304</sup> *Lucas*, 112 S. Ct. at 2901-02.

<sup>305</sup> See, e.g., *Loveladies Harbor, Inc. v. United States*, 21 Cl. Ct. 153, 161 (1990) (noting denial of Corps permit to fill 12.5 acres was taking and awarded judgment of \$2,658,000); *Florida Rock Indus., Inc. v. United States*, 23 Cl. Ct. 653, 555 (1991) (granting landowner \$1,029,000 in compensation for 98 acre taking).



endangered species habitat,<sup>306</sup> from reductions in grazing allotments,<sup>307</sup> and even from the adoption of a stringent BAT under the CWA.<sup>308</sup>

The outcome of these cases on alternatives-based decision-making has yet to be seen. "Takings" law remains uncertain as to the size of the parcel of property owned and affected, the reasonableness of the expectation that it could be developed, the degree of intrusion allowed and the value of the remaining economic uses.<sup>309</sup> However individual cases are decided, the Court has thrown a chill over regulation that would require interests vested in A to do B instead, or to do it at C location. Caveat regulator.

## V. CONCLUDING THOUGHTS

Alternatives are strong medicine. Almost too strong for their own good. The power that they have brought to federal environmental decision-making has succeeded in breaking the logjam of pollution control and in protecting natural resources of incalculable value. In more than a dozen federal programs seeking to achieve everything from zero discharge to social equity in hazardous waste siting decisions, the no-less-damaging-alternative standard emerges as the control mechanism, the bottom line.

This line of evolution may not hold. No single line of evolution ever does. Already scurrying around environmental law's jungle floor are new prototypes that may work even better. Some are cutting their teeth on problems like markets for sulfur oxides and mitigation banks. Some may emerge simply as additional per-pollutant fees. They are still quite young, however, and — although the subject of intense promotion — they have their problems. For the moment, alternatives

---

<sup>306</sup> *Gilsson v. Alachua County*, 558 So. 2d 1030, 1033-34 (Fla. Dist. Ct. App. 1990).

<sup>307</sup> *McKinley v. United States*, 828 F. Supp. 888, 893 (D.N.M. 1993). In *McKinley*, the court found that a 44% reduction in grazing area was not a taking. *Id.*

<sup>308</sup> *Rybachek*, 904 F.2d at 1282-83 (discussing regulation of placer mining discharge).

<sup>309</sup> John A. Humbach, *Evolving Thresholds of Nuisance and the Takings Clause*, 18 COLUM. J. ENVTL. L. 1, 26-28 (1993); see also *Inverse Condemnation and Related Government Liability*, ALI-ABA STUDY MATERIALS (1993).

rule. We would do well to support them against their many critics until whatever approaches that come next have established that they will indeed do more.





*FRYE* GONE, BUT NOT FORGOTTEN IN THE WAKE OF *DAUBERT*:  
NEW STANDARDS AND PROCEDURES FOR ADMISSIBILITY OF  
SCIENTIFIC EXPERT OPINION

I. INTRODUCTION

The issue of admissibility of scientific opinion evidence has been a source of increasing controversy in state and federal courts. Particularly in the area of toxic tort litigation, dispute has arisen over the applicable legal standards for determining the admissibility of an expert's testimony. Some federal courts apply a combination of both the Federal Rules of Evidence ("Federal Rules") and the *Frye* rule, which excludes novel scientific expert opinion testimony unless the principles upon which it is based have achieved "general acceptance" within the scientific community.<sup>1</sup> Other courts specifically reject *Frye* and determine admissibility based primarily on the Federal Rules. The United States Supreme Court recently resolved this controversy at the federal level in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,<sup>2</sup> holding that the Federal Rules superseded *Frye*'s general acceptance standard as the primary test for the admissibility of scientific evidence.<sup>3</sup>

More significantly, a seven member majority of the Court expanded the trial judges' gatekeeping role by requiring them to determine the evidentiary reliability and relevancy of the proffered scientific evidence.<sup>4</sup> Trial judges are now required to become more active in the expert witness process, and they must define the scope of their "gatekeeper" role. Trial attorneys

---

<sup>1</sup> *Frye v. United States*, 293 F. 1013, 1014 (D.C. Cir. 1923).

<sup>2</sup> \_ U.S. \_\_\_, 125 L. Ed. 2d 469 (1993).

<sup>3</sup> *Daubert*, 125 L. Ed. 2d at 480 (citing *Frye*, 293 F. at 1014).

<sup>4</sup> *Id.* at 482. Chief Justice Rehnquist and Justice Stevens concurred in part and dissented in part. *Id.* at 486. Although *Frye* applied to only novel scientific evidence, the Court expressly stated that this new standard applies to all scientific evidence. *Id.* at 482 n.11.

will find that they may have to change their selection, preparation, and use of expert witnesses, as well as their development of pretrial strategies, i.e. pre-trial motions, jury instructions, and cross-examinations.

The Supreme Court of Mississippi has not ruled on the admissibility of scientific opinion evidence since the *Daubert* decision. While it is unclear whether or not the Mississippi Supreme Court will follow the specific guidelines established by *Daubert*, this recent federal decision may well affect the future admissibility of scientific opinion evidence given that Mississippi's Rules of Evidence are patterned after the Federal Rules. This comment will analyze the Supreme Court's decision and discuss the admissibility of expert opinion evidence in federal courts in light of *Daubert*. Additionally, this comment will briefly address the admissibility of expert testimony in Mississippi state courts.

## II. THE RISE AND FALL OF *FRYE*

In *Frye v. United States*, defendant appealed his murder conviction asserting that the lower court erred in excluding defendant's expert witness,<sup>5</sup> who would have provided opinion testimony on the validity and reliability of a systolic blood pressure deception test.<sup>6</sup> The trial court ruled that such experimental scientific principles should be afforded no evidentiary weight.<sup>7</sup> In affirming the exclusion of the expert's testimony, the District of Columbia Court of Appeals held that testimony based upon scientific principle was not admissible until the principle from which it was derived was "sufficiently established to have gained 'general acceptance' in the particular

---

<sup>5</sup> *Frye*, 293 F. at 1013-14.

<sup>6</sup> *Id.* This test is similar to a polygraph, and was considered novel by the Court. *Id.* at 1014.

<sup>7</sup> *Id.* at 1014. The court of appeals noted that the deception test had not acquired such scientific standing to warrant the admission of an expert opinion based on such principles. *Id.*

field in which it belong[ed]."<sup>8</sup> This rule has become known as the *Frye* "general acceptance" test.

Despite the initial acceptance of *Frye*,<sup>9</sup> many courts and scholars criticized the test.<sup>10</sup> Some courts found the "general acceptance" standard too malleable to be effective.<sup>11</sup> Other courts determined that the *Frye* standard was too rigid and

<sup>8</sup> *Id.* The court stated that:

Just when a scientific principle or discovery crosses the line between the experimental and the demonstrable stages is difficult to define. Somewhere in this twilight zone the evidential force of the principle must be recognized, and while courts will go a long way in admitting expert testimony deduced from a well-recognized scientific principle or discovery, the thing from which the deduction is made must be sufficiently established to have gained general acceptance in the particular field in which it belongs.

*Id.*

<sup>9</sup> Paul C. Giannelli, *Frye v. United States*, 99 F.R.D. 189, 189-90 (1983) (symposium report). Courts justified the adoption of *Frye* for a number of reasons. Some courts reasoned that the general acceptance standard screened out unreliable scientific evidence. *United States v. Addison*, 498 F.2d 741, 743-44 (D.C. Cir. 1974); see *United States v. Fohsher*, 590 F.2d 381, 383 (1st Cir. 1979) (stating *Frye* provided method for courts to assess reliability of novel scientific expert testimony); *People v. Barbara*, 255 N.W.2d 171, 194 (Mich. 1977) (holding *Frye* allowed knowledgeable experts to determine reliability by experimentation and study before lay jury used science to make factual finding). Other courts hoped that *Frye* would bring uniformity of decision. See, e.g., *People v. Kelly*, 549 P.2d 1240, 1244-45 (Cal. 1976). Still others reasoned that *Frye* would guard against prejudicial effects of testimony based on unsubstantiated hypotheses. See, e.g., *United States v. Brown*, 557 F.2d 541, 556 (6th Cir. 1977).

<sup>10</sup> Giannelli, *supra* note 9, at 192. Some commentators declared the standard "archaic" and "antiquated on the day of its pronouncement." *Id.* (quoting Andre A. Moenssens, *Polygraph Tests Results Meet Standards for Admissibility as Evidence*, LEGAL ADMISSIBILITY OF POLYGRAPH 14, 19 (N. Ansley ed. 1975)); see Conrad, *Landmarks and Hallmarks in Scientific Evidence*, SOURCEBOOK IN CRIMINALISTICS 37, 38 (C. Hormachea ed. 1974). See generally *United States v. Williams*, 583 F.2d 1194, 1197-98 (2d Cir. 1978) (modifying *Frye* standard), *cert. denied*, 439 U.S. 1117 (1979); *United States v. Bennett*, 539 F.2d 45, 53 (10th Cir.) (adopting varied version of *Frye*), *cert. denied*, 429 U.S. 925 (1976); *United States v. Baller*, 519 F.2d 463, 465 (4th Cir.) (altering traditional *Frye* rule), *cert. denied*, 427 U.S. 1019 (1975).

<sup>11</sup> *Williams*, 583 F.2d at 1198. In *Williams*, the court noted that the vague terms of the *Frye* test allowed courts to manipulate the parameters of the relevant scientific community. *Id.*; see Paul C. Giannelli, *The Admissibility of Novel Scientific Evidence: Frye v. United States, A Half-Century Later*, 80 COLUM. L. REV. 1197, 1228 (1980) [hereinafter *A Half-Century Later*] (noting jurisdictions which modified *Frye*).



excluded probative information from the jury's consideration.<sup>12</sup> The most substantive challenge to *Frye* was the argument that it did not survive the adoption of the Federal Rules<sup>13</sup>

Aside from the failings of *Frye*, courts have also re-examined the issues surrounding the admissibility of expert scientific testimony because of the growing concern regarding how the justice system may accommodate scientific and technological advancements.<sup>14</sup> The tension between science and law stems from the differing processes by which these two disciplines develop. Law fosters uniformity and requires a quick and final decision based upon sound arguments.<sup>15</sup> Law does not have the capacity to contemplate erroneous or unsupported theories when reaching a final legal conclusion.<sup>16</sup> Science, on the other hand, considers a wide range of hypotheses which later may be proven or disproven.<sup>17</sup> It is through this changing and complex process that science develops. Thus, it becomes problematic to make a legal judgment based upon scientific opinions

---

<sup>12</sup> *United States v. Samples*, 378 F. Supp. 44, 53 (E.D. Pa. 1974). In *Samples*, the court noted that *Frye* precluded too much relevant evidence. *Id.* Moreover, the court noted that the general acceptance standard was more appropriate for taking judicial notice of facts, but not for determining the admissibility of scientific evidence. *Id.* (citing MCCORMICK ON EVIDENCE § 203, at 491 (2d ed. 1972)). See generally Frederick B. Lacey, *Scientific Evidence*, 24 JURIMETRICS J. 254, 265 (1984) (stating that *Frye* rule hindered judicial process).

<sup>13</sup> *Daubert*, 125 L. Ed. 2d at 480. Those who argued that *Frye* did not survive the enactment of the Federal Rules relied primarily on Rules 401, 202, and 702. *A Half-Century Later*, *supra* note 11, at 1230; 3 JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN'S EVIDENCE, ¶ 702[03], at 702-36 to -37 (1988). See generally, 22 CHARLES A. WRIGHT & KENNETH W. GRAHAM, FEDERAL PRACTICE AND PROCEDURE § 5168 (1978). *Daubert* went a step further and also relied on Federal Rule 104(a) (discussing trial judge's gatekeeping role). *Daubert*, 125 L. Ed. 2d at 482. Proponents of the *Frye* rule, however, argued that neither the Advisory Committee Notes, the Congressional Committee Reports, nor the floor debates or hearings on the Federal Rules made any reference to *Frye*. *A Half-Century Later*, *supra* note 11, at 1229. Moreover, the Federal Rules were not meant to codify all rules of evidence. *Id.* Some rules, such as impeachment by evidence of bias, were not mentioned in the Federal Rules, yet are still applied by the courts. *Id.*

<sup>14</sup> *A Half-Century Later*, *supra* note 11, at 1198.

<sup>15</sup> *Daubert*, 125 L. Ed. 2d at 485. The Court recognized the significant differences between "truth" in a courtroom versus "truth" in a laboratory. *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

which may or may not be subsequently validated, modified, or disproven. Prior to *Daubert*, Judge Higginbothom of the Court of Appeals for the Fifth Circuit recognized this danger and wrote that it had become too routine to admit "experts' or 'studies' on the fringes of or even well beyond the outer parameters of mainstream scientific or medical views to be presented to juries as valid evidence from which conclusions can be drawn."<sup>18</sup>

While some circuits, including the Fifth Circuit, still applied the general acceptance standard as part of their analysis,<sup>19</sup> others rejected *Frye* and advocated various approaches ranging from a modified *Frye* standard<sup>20</sup> to a more liberal approach favoring admissibility of expert opinion.<sup>21</sup> This split in the circuits was resolved by the United States Supreme Court in *Daubert*.

<sup>18</sup> *Brock v. Merrell Dow Pharmaceuticals, Inc.*, 884 F.2d 167, 169 (5th Cir. 1989) (Higginbothom, J., dissenting) (quoting Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis Insurance Availability and Affordability (February 1986)). Judge Higginbothom further stated that reliance upon "junk science" has resulted in findings of causation which have no scientific bases. *Id.* The Fifth Circuit specifically addressed Judge Higginbothom's concerns in *Christophersen v. Allied-Signal Corp.*, 939 F.2d 1106, 1111 n.8 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 1280 (1992). In *Christophersen*, the court set forth a four-factor analysis governing admissibility of expert testimony. *Christophersen*, 939 F.2d at 1110. This analysis included examining the expert testimony in light of Federal Rules 702, 703, 403 and *Frye*. *Id.*

<sup>19</sup> *Christophersen*, 939 F.2d at 1111. The Fifth Circuit, however, did not apply *Frye* as the sole requirement for admissibility. *Id.* at 1110. The *Christophersen* court also looked to the Federal Rules. *Id.* at 1110-15.

<sup>20</sup> *See supra* note 13.

<sup>21</sup> *United States v. Ferri*, 778 F.2d 985 (3d Cir. 1985), *cert. denied*, 476 U.S. 1172, *cert. denied*, 479 U.S. 831 (1986). In *Ferri*, the prosecution proffered an anthropology expert who conducted a footprint identification test and testified that the shoes found at the scene of the crime belonged to the defendant. *Ferri*, 778 F.2d at 988. Ultimately, the defendant was convicted. *Id.* at 987. The district court recognized that the expert's techniques of impression comparison were not a generally accepted methodology in her field. *Id.* at 988 n.2. However, the trial court applied a flexible approach to the admissibility of expert testimony and held that the identification method was reliable. *Id.* at 988. The Court of Appeals for the Third Circuit affirmed the ruling. *Id.*

### III. DAUBERT

#### A. Procedural History

In *Daubert*, petitioners<sup>22</sup> sued respondent<sup>23</sup> alleging that the ingestion of respondent's manufactured anti-nausea drug, Bendectin, caused petitioners' birth defects.<sup>24</sup> Prior to trial, respondent moved for summary judgment arguing that Bendectin did not cause birth defects,<sup>25</sup> and that petitioners could offer no admissible evidence of causation.<sup>26</sup> Petitioners' experts relied on four types of studies to support their allegation: (1) "in vivo" (live), and (2) "in vitro" (test tube) animal studies, (3) chemical structure analysis, and (4) re-analysis of previously published epidemiology studies.<sup>27</sup> In granting respondent's motion for summary judgment, the district court ruled that petitioners' experts did not establish causation by using a methodology generally accepted within the scientific community; thus, the court rejected such evidence for purposes of establishing a genuine issue of material fact.<sup>28</sup> The Court

---

<sup>22</sup> *Daubert*, 125 L. Ed. 2d at 476. Petitioners were William Daubert, Eric Schuller, and guardians ad litem. *Id.*

<sup>23</sup> *Id.* Respondent was Merrell Dow Pharmaceuticals, Inc. *Id.*

<sup>24</sup> *Id.* Petitioners originally filed suit in state court and respondent removed the action to federal court on diversity grounds. *Id.* Merrell Dow had been sued in similar suits throughout the country. *In re Bendectin Litig.*, 857 F.2d 290 (6th Cir. 1988), *cert. denied*, 488 U.S. 1006 (1989); *see, e.g., Mekdeci v. Merrell Nat'l Labs.*, 711 F.2d 1510 (11th Cir. 1983) (filing first Bendectin case); *Oxendine v. Merrell Dow Pharmaceuticals*, 563 A.2d 330 (D.C. 1989) (initiating more Bendectin litigation), *cert. denied*, 493 U.S. 1074 (1990). *See generally* Joseph Sanders, *The Bendectin Litigation: A Case Study in the Life Cycle of Mass Torts*, 43 HASTINGS L.J. 301, 385 (1992) (conducting case study of Bendectin, noting empirical studies).

<sup>25</sup> *Daubert*, 125 L. Ed. 2d at 477 (citing *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 727 F. Supp. 570, 572 (S.D. Cal. 1989)). Respondent submitted an affidavit of a physician/epidemiologist who reviewed thirty published studies involving 130,000 subjects and concluded that the ingestion of Bendectin did not cause birth defects. *Id.* at 476.

<sup>26</sup> *Id.* Petitioners offered the testimony of eight experts who concluded that Bendectin caused birth defects. *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 477 (citing *Daubert*, 727 F. Supp. at 572) (quoting *United States v. Kilgus*, 571 F.2d 508, 510 (9th Cir. 1978)). The district court stated that the scientific



of Appeals for the Ninth Circuit affirmed, relying on *Frye*, holding that where the methodology relied upon by experts was neither subjected to peer review nor published, the opinion evidence did not satisfy the "general acceptance" test.<sup>29</sup> Thereafter, the United States Supreme Court granted petitioners' writ of certiorari to settle the issue of admissibility of scientific evidence in federal courts.<sup>30</sup>

On June 28, 1993, the United States Supreme Court in *Daubert*, vacated and remanded the decision of the Court of Appeals for the Ninth Circuit. The Court held that the Federal Rules superseded *Frye*, and that the "general acceptance" of a scientific theory was no longer the sole prerequisite for admissibility of scientific expert testimony.<sup>31</sup> The Court stated that

---

principles relied upon by petitioners did not meet the admissibility standard because they were not published or subjected to peer review. *Id.* Prior to *Daubert*, the First, Fifth, and District of Columbia Circuits had held that these types of analyses do not establish a sufficient foundation to conclude that Bendectin caused birth defects. *Lynch v. Merrell Nat'l Labs.*, 830 F.2d 1190, 1194 (1st Cir. 1987); *Brock*, 874 F.2d at 313-15; *Richardson v. Richardson-Merrell, Inc.*, 857 F.2d 823, 825 (D.C. Cir. 1988), *cert. denied*, 493 U.S. 882 (1989), respectively; see also Michael Dore, *A Commentary on the Use of Epidemiological Evidence In Demonstrating Cause-In-Fact*, 7 HARV. ENVTL. L. REV. 429, 438-39 (1983) (discussing flaws of re-analysis).

Similarly, the Court of Appeals for the Sixth Circuit addressed this identical issue in a post-*Daubert* Bendectin decision. *Elkins v. Richardson-Merrell, Inc.* No. 92-6172, 1993 WL 413981, \*1 (6th Cir. Oct. 20, 1993). In *Elkins*, plaintiffs again relied on the scientific tests used in *Daubert* and other Bendectin cases. *Id.* at \*1. The Sixth Circuit again found the above tests insufficient to support plaintiffs' claim of causation. *Id.* at \*2.

<sup>29</sup> *Daubert*, 125 L. Ed. 2d at 477. The Ninth Circuit determined that petitioners' experts based their opinions on techniques which significantly diverged from methodology relied upon by experts in their field. *Id.* (citing *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 951 F.2d 1128, 1129-30 (9th Cir. 1991)) (quoting *United States v. Solomon*, 753 F.2d 1522, 1526 (9th Cir. 1985)). The Ninth Circuit noted that other jurisdictions refused to admit similar expert opinion primarily because the re-analysis of epidemiological studies was neither subjected to peer review nor published in scientific journals. *Daubert*, 951 F.2d at 1130.

<sup>30</sup> *Daubert*, 125 L. Ed. 2d at 478. Compare *Christophersen*, 939 F.2d at 1111 (applying *Frye* in conjunction with other Federal Rules) with *Deluca v. Merrell Dow Pharmaceuticals*, 911 F.2d 941, 955 (3d Cir. 1990) (rejecting *Frye*), *aff'd*, 6 F.3d 778 (1993), *cert. denied*, 114 S. Ct. 691 (1994).

<sup>31</sup> *Daubert*, 125 L. Ed. 2d at 480. The Court examined the legislative history of the Federal Rules and found no reference to the *Frye* standard. *Id.* The Court concluded, as did many commentators and litigants before, that the Federal Rules were not

because Federal Rule 702 directly addressed the evidentiary issue in *Daubert*, the application of the "rigid 'general acceptance' requirement would be at odds with the 'liberal thrust' of the Federal Rules."<sup>32</sup> The Court further held that a trial judge must utilize Federal Rule 104(a) to determine whether: (1) the methodology used by the proffered expert was scientifically valid; and (2) the evidence would assist the trier of fact to understand a fact at issue.<sup>33</sup> Moreover, the Court emphasized that proffered evidence should be analyzed pursuant to Federal Rules 403, 703, and 706.<sup>34</sup>

### B. *The Court's Analysis of the Federal Rules of Evidence*

#### 1. *Federal Rule of Evidence 702*

The Court relied on Federal Rule 702 to reject the exclusive reliance upon *Frye*, and to develop a more flexible approach to the issue of admissibility of scientific evidence.<sup>35</sup> The Court noted that while the Federal Rules were flexible, they still provided definite limits to the admissibility of such expert

---

intended to incorporate *Frye*. *Id.*

<sup>32</sup> *Id.* (quoting *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 169 (1945)); see also Jack B. Weinstein, *Rule 702 of the Federal Rules of Evidence Is Sound; It Should Not Be Amended*, 138 F.R.D. 631, 631 (1991) (symposium report) (advocating continued breadth of Federal Rules and liberal admissibility standards).

<sup>33</sup> *Daubert*, 125 L. Ed. 2d at 482.

<sup>34</sup> *Id.* at 484. The Court also observed that Federal Rules 701 and 703, allowing experts, unlike other witnesses, to offer opinions and testify about matters of which they have no first-hand knowledge. *Id.* at 482 (citing FED. R. EVID. 701, 703). Thus, the Court stressed the importance of using these Federal Rules to determine the validity and reliability of scientific evidence. *Id.* at 484. To safeguard further the admission of expert testimony, the Court recognized that Federal Rules 104(a) and 403 require judges to determine whether the expert opinion will assist the jury in determining a necessary fact, or whether the opinion's probative value is outweighed by its unfairly prejudicial effect. FED. R. EVID. 104(a), 403.

<sup>35</sup> *Daubert*, 125 L. Ed. 2d at 482. Rule 702 provides that:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

FED. R. EVID. 702.

testimony.<sup>36</sup> Specifically, trial courts must find that the evidence is both reliable and relevant before it is admitted under the Federal Rules.<sup>37</sup>

To determine reliability, trial judges must first conclude that the "scientific knowledge" advanced by the expert is appropriately derived from scientific methods.<sup>38</sup> To ensure scientific validity, the proposed testimony must be supported by "good grounds," or by "what is known."<sup>39</sup> Such support insures that expert opinions provide more than mere speculation.<sup>40</sup>

<sup>36</sup> *Daubert*, 125 L. Ed. 2d at 480. The Fifth Circuit, before *Daubert*, expressed concerns about the improper use of experts and the danger of a "let it all in" philosophy. In the case of *In re Air Crash Disaster at New Orleans, La.*, 795 F.2d 1230 (5th Cir. 1986), the appellants argued that Rule 702 fostered a broadened scope of admissibility. *In re Air Crash*, 795 F.2d at 1234. The court stated that it would examine the admissions of expert testimony "with a sharp eye," and would send the message to the courts "to take hold of expert testimony in federal trials." *Id.*; see also *Randolph v. Laeisz*, 896 F.2d 964, 968 (5th Cir. 1990) (advocating control of experts in federal trials); *Viterbo v. Dow Chemical*, 826 F.2d 420, 422 (5th Cir. 1987) (stating admissibility of expert testimony should not fall prey to broad philosophy).

<sup>37</sup> *Daubert*, 125 L. Ed. 2d at 480.

<sup>38</sup> *Id.* To make this reliability determination, judges must undertake a preliminary assessment of whether the expert's underlying methodology or reasoning is scientifically valid and appropriately applied to the facts in issue. *Id.*

<sup>39</sup> *Id.* This focus on "scientific validity" is much the same as that followed by the Fifth Circuit in *Christophersen*, although that analysis was made under the rubric of the *Frye* test. Clifton T. Hutchinson, '*Daubert*' Confirms Judge's Gatekeeper Role, [Summer/Fall 1993] 21 PRODUCT SAFETY & LIABILITY REP. (BNA) No. 30, pt. II, at 12. In *Christophersen*, the court looked behind the expert's opinion to determine the validity of the methodology utilized by the expert. *Christophersen*, 939 F.2d at 1115. In affirming the summary judgment for the defendant, the court determined that the plaintiffs' expert's methodology did not connect the facts to the conclusion in a "scientifically valid way." *Id.*

<sup>40</sup> *Daubert*, 125 L. Ed. 2d at 481. In the case of *In re Air Crash*, the Fifth Circuit reversed the plaintiffs' recovery for loss of inheritance holding that the expert evidence was too speculative. *In re Air Crash*, 795 F.2d at 1235. In that case plaintiffs' economics expert evaluated the deceased's earning capacity and projected future earnings and tax considerations. *Id.* at 1234. The economist erroneously calculated future income consumption based on average statistical studies and not on the facts peculiar to the deceased. *Id.* The court of appeals held that the economist did not base his opinion on accepted methods of calculation and offered only mere conjecture. *Id.*; see, e.g., *Brown v. Parker-Hannifin Corp.*, 919 F.2d 308, 311-12 (5th Cir. 1990) (affirming exclusions of expert testimony where expert speculating about two potential causes of mechanical failure without any basis for ruling out equally plausible alternatives causes); *Marks v. Pan Am. World Airways, Inc.*, 785 F.2d 539, 542 (5th Cir. 1986) (ruling damage award may not stand on speculative evidence) (quoting *Haley v.*



Once these determinations are made, the proffered testimony meets the reliability requirement of Rule 702.<sup>41</sup>

Prior to *Daubert*, many courts, such as the Court of Appeals for the Third Circuit in the case of *United States v. Downing*,<sup>42</sup> also followed the flexible approach to reliability. In *Downing*, the district court excluded the government's expert evidence on eyewitness perception and memory, and held that such testimony would never assist the trier of fact.<sup>43</sup> The court of appeals vacated and remanded for a specific determination of the reliability of the proffered expert opinion in light of the policies of Federal Rule 702.<sup>44</sup> The *Downing* court recognized reliability as a critical element of admissibility but maintained that the flexible inquiry should turn on a number of factors.<sup>45</sup> This is not to say that there is not a point at which evidence becomes unreliable. However, with the flexible approach articulated by

---

Pan Am. World Airways, 746 F.2d 311, 316 (5th Cir. 1984)).

The Mississippi Supreme Court has similarly held that expert opinion is admissible only where it is stated with reasonable certainty and not pure supposition. *West v. State*, 553 So. 2d 8, 20 (Miss. 1989); see also *Fowler v. State*, 566 So. 2d 1194, 1200 (Miss. 1990) (holding purely speculative opinions inadmissible). Similarly, Mississippi trial courts must exclude expert opinions expressed in terms of mere possibilities and broad generalizations. *Pharr v. Anderson*, 436 So. 2d 1357, 1360 (Miss. 1983).

<sup>41</sup> *Daubert*, 125 L. Ed. 2d at 481. This analysis establishes a standard of "evidentiary reliability," or "trustworthiness" required for admissibility. *Id.* Thus, evidence would be reliable if it was "based on scientifically valid principles." *Id.*

<sup>42</sup> 753 F.2d 1224 (3d Cir.), *aff'd*, 780 F.2d 1017 (3d Cir. 1985).

<sup>43</sup> *Downing*, 753 F.2d at 1229. In *Downing*, the defendant was indicted on charges of mail and wire fraud and was convicted based primarily on the testimony of twelve eyewitnesses. *Id.* at 1227. Defendant attempted to offer expert testimony on the unreliability of eyewitness testimony. *Id.* at 1228. The district court refused to allow such testimony on the ground that it involved questions within the comprehension of a lay jury so it would not assist the trier of fact. *Id.* at 1229-30. The trial court did not examine the reliability of the testimony as it was held inadmissible on other grounds. *Id.* at 1232. The court of appeals, however, discussed the necessity of a reliability determination and remanded the case for such determination. *Id.*

<sup>44</sup> *Id.* at 1238.

<sup>45</sup> *Id.* The Third Circuit directed the trial court to analyze certain factors in considering reliability. *Id.* The district court should review: (1) the novelty of the scientific method used; (2) the acceptance of the method; (3) the determination of the relevant scientific community; and (4) the frequency with which the method leads to erroneous results. *Id.* at 1238-39. These factors are essentially the same as those outlined by the Supreme Court in *Daubert*.

*Daubert* and the Court's reliance on *Downing*, courts may continue to err on the side of admissibility.<sup>46</sup>

The Supreme Court in *Daubert* also held that Federal Rule 702 requires trial courts to determine the relevancy of the proffered opinion as a prerequisite to admissibility. The trial judge must assess whether the expert testimony would assist the fact finder in understanding the evidence or determining a fact in issue.<sup>47</sup> The proffered evidence will meet this "helpfulness" standard if the methodology utilized by the expert is sufficiently reliable and the resultant opinion has a valid scientific connection to the relevant issues and facts.<sup>48</sup> In other words, the opinion must "fit" the facts of the case.<sup>49</sup> However, deciding what testimony "fits" the issue at hand is not always an easy determination.<sup>50</sup> For what may be scientifically valid for one purpose is not automatically scientifically valid for an alternate purpose.<sup>51</sup> Thus, Federal Rule 702's criteria

---

<sup>46</sup> See *United States v. Martinez*, No. 91-1996, 1993 WL 330682, at \*5 (8th Cir. Sept. 2, 1993) (discussing post-*Daubert* flexible reliability inquiry and its effects on admissibility), *cert. denied*, 114 S. Ct. 734 (1994).

<sup>47</sup> *Daubert*, 125 L. Ed. 2d at 481 (citing FED. R. EVID. 702). If the offered scientific evidence does not relate to any issue, then such evidence it is irrelevant and inadmissible. *Id.*

<sup>48</sup> *DeLuca*, 911 F.2d at 957 (quoting 3 WEINSTEIN'S EVIDENCE, ¶ 702[03], at 702-35). Therefore, reliability is also a prerequisite to determining relevancy.

<sup>49</sup> *Daubert*, 125 L. Ed. 2d at 481; see *Edmonds v. Illinois Cent. Gulf R.R.*, 910 F.2d 1284, 1286-87 (5th Cir. 1990) (excluding studies which suggested link of causation but did not relate studies to facts of case). The Supreme Court also relied heavily on *Downing's* reasoning for this concept of relevancy. Where a defendant is seeking to rely on expert testimony, that defendant must make an on the record proffer of how the expert's testimony is relevant to the facts and issues in the case. *Downing*, 753 F.2d at 1242. The absence of such a proffer may be sufficient grounds to exclude the expert's opinion testimony. *Id.*; see also *Fohsher*, 590 F.2d at 383 (stating that exclusion is proper where there is no evidence that expert testimony concerns matter at issue).

<sup>50</sup> *Daubert*, 125 L. Ed. 2d at 481-82. Moreover, the Supreme Court's discussion of the breadth of the Federal Rules and the flexible approach to admissibility may easily be traced to *Downing*. The *Downing* court expressly looked to the "spirit" of the Federal Rules, and more particularly to Rule 702, and explicitly rejected *Frye*. *Downing*, 753 F.2d at 1237.

<sup>51</sup> *Daubert*, 125 L. Ed. 2d at 482. The Court gave an illustrative example of this point. *Id.* A study of the phases of the moon may furnish "scientific knowledge" about whether the night in question was dark. *Id.* If a party offered the same expert opinion, however, to support an argument that the party behaved irrationally because of the moon, then such opinion would not assist the fact finder absent some reliable grounds

that the expert opinion "assist the trier of fact" requires a valid scientific connection to the relevant issue as a prerequisite to admissibility.<sup>52</sup>

Federal Rule 702 also requires that a proffered expert be "qualified by knowledge, skill, experience, training, or education" before he or she may be allowed to offer an opinion.<sup>53</sup> Although the experts' qualifications were not at issue in *Daubert*, this facet of Federal Rule 702 is highly relevant. The Fifth Circuit has recognized the importance of a careful examination of an expert's qualifications.<sup>54</sup> Qualifying an expert requires more than reviewing the "expert's" credentials or curriculum vitae.<sup>55</sup> The proffered expert must have specialized knowledge and experience in the particular matter at issue.<sup>56</sup> Thus, a board licensed medical doctor is not qualified to give a medical opinion on every medical question.<sup>57</sup>

## 2. Federal Rule of Evidence 104(a)

The Supreme Court in *Daubert* explicitly recognized the necessity for heightened judicial activism when considering

---

to support such a connection. *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> FED. R. EVID. 702.

<sup>54</sup> *Christophersen*, 939 F.2d at 1112; see also *Peteet v. Dow Chemical Co.*, 868 F.2d 1428, 1431 (5th Cir.) (noting necessity for strict scrutiny of expert qualifications), *cert. denied*, 493 U.S. 935 (1989); *Frazier v. Continental Oil Co.*, 568 F.2d 378, 383 (5th Cir. 1978) (holding court must make initial determination as to qualification of experts). In *Christophersen*, the plaintiff's husband died of a rare colon cancer. *Christophersen*, 939 F.2d at 1108. Plaintiff offered Dr. Miller as an expert to prove that the fumes in her husband's work-place caused the cancer. *Id.* Although the proffered expert was a physician, he was neither an oncologist nor a pathologist, nor did he routinely treat cancer patients. *Id.* at 1108. Although the court did not base the exclusion of Dr. Miller's testimony solely on these grounds, the court carefully reviewed his qualifications. *Id.* at 1109. The court of appeals affirmed the district court's exclusion of Dr. Miller's testimony. *Id.*

<sup>55</sup> *Christophersen*, 939 F.2d at 1112.

<sup>56</sup> *Viterbo*, 826 F.2d at 422.

<sup>57</sup> *Christophersen*, 939 F.2d at 1113; see also *O'Conner v. Commonwealth Edison Co.*, 807 F. Supp. 1376, 1390 (C.D. Ill. 1992) (stating that Federal Rules recognize limits which expert's expertise cannot go beyond and medical doctors willing to proclaim principles based on limited experience will not assist trier of fact), *aff'd*, 1994 WL 3794 (1994).



scientific evidence.<sup>58</sup> It is no longer acceptable for judges merely to admit all expert opinion evidence and to leave it up to the jury to decide what is relevant and to resolve the conflicting opinions.<sup>59</sup> Notably, *Daubert* now places an affirmative duty on the trial judge to conduct a hearing prior to the time the jury hears from the expert, to determine the scientific validity of proffered scientific evidence.<sup>60</sup>

Although the Court did not specifically define scientific validity, it identified four factors to be considered by the judiciary in making the required determination. The Court stressed that its list of factors was not exhaustive.<sup>61</sup> First, the trial court should determine whether the theory espoused by the expert has been tested.<sup>62</sup> Second, the trial court must

<sup>58</sup> Similarly, the Fifth Circuit has admonished trial courts to "take hold of expert testimony in federal trials." *In re Air Crash*, 795 F.2d at 1234.

<sup>59</sup> In *Brock*, Judge Higginbotham discussed in his dissent the potential problems for letting conflicting expert opinions go to a lay jury. *Brock*, 884 F.2d at 169 (Higginbotham, J., dissenting). Judge Learned Hand noted two problems with the proliferation of admitting conflicting expert testimony. First, each proffered expert may be naturally biased as well as enticed by his or her collection of fees. *Id.* (citing Learned Hand, *Historical and Practical Considerations Regarding Expert Testimony*, 15 HARV. L. REV. 40, 53 (1901)). And second, the jury has no rational basis for resolving an area where two specialized professionals disagree. *Id.* Similarly, the Fifth Circuit recognized this problem and stated that experts whose testimony may be skewed and/or available to the highest bidder should not be allowed to offer such evidence in a courtroom. *In re Air Crash*, 795 F.2d at 1234.

<sup>60</sup> *Daubert*, 125 L. Ed. 2d at 482. Rule 104(a) provides in part:

Preliminary questions concerning the qualification of a person to be a witness, the existence of a privilege, or the admissibility of evidence shall be determined by the court, subject to the provisions of subdivision (b) . . . . In making its determination it is not bound by the rules of evidence except those with respect to privileges.

FED. R. EVID. 104(a). The burden of proving the reliability of the proffered testimony remains on the proponent of the evidence. *Bourjaily v. United States*, 483 U.S. 171, 175-76 (1987).

<sup>61</sup> *Daubert*, 125 L. Ed. 2d at 483.

<sup>62</sup> *Id.* The Court stated that testing was vital to determine if the hypotheses could be falsified and/or duplicated. *Id.* (citing Michael D. Green, *Expert Witnesses and Sufficiency of Evidence in Toxic Substances Litigation: The Legacy of Agent Orange and Bendectin Litigation*, 86 NW. U. L. REV. 643, 645 (1992); KARL POPPER, *CONJECTURES AND REFUTATIONS: THE GROWTH OF SCIENTIFIC KNOWLEDGE* 37 (5th ed. 1989)). The Court, however, addressed the other three factors as being "pertinent considerations." *Id.* Thus, this distinction may give rise to an argument that the testing factor weighs

consider whether the theory has been subjected to peer review and published in a scientific journal.<sup>63</sup> Third, the trial court should consider the theory's known or potential rate of error found in the scientific process relied upon by the expert.<sup>64</sup> Finally, the Court stated that the "general acceptance" of the underlying principles and methodology continues to be a factor in the determination of admissibility.<sup>65</sup> The Court again

---

more heavily than the other three factors.

<sup>63</sup> *Daubert*, 125 L. Ed. 2d at 483. The Court relied on peer review and publication as these processes are the safeguards which the scientific community uses to police itself. JOHN M. ZIMAN, *RELIABLE KNOWLEDGE: AN EXPLORATION OF THE GROUNDS FOR BELIEF IN SCIENCE* 130-32 (1978). Although the scientific community encourages the development of innovative theories, these must be reviewed to avoid building later theories on flawed hypotheses. *Solarex Corp. v. Arco Solar, Inc.*, 121 F.R.D. 163, 167-68, *aff'd*, 870 F.2d 642 (Fed. Cir. 1989); *see also* *Dowd v. Calabrese*, 585 F. Supp. 430, 432 (D.D.C. 1984) (stating scientific truth requires maturation of consensus of scientific procedures). In many ways, this review process not only reflects scientific methods, it is scientific method. ZIMAN, *supra* at 132; *see* Amicus Brief for the American Association for the Advancement of Science and the National Academy of Sciences at 13-18, *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 125 L. Ed. 2d. 469 (1993) (January 19, 1993) (No. 92-102). The Court ultimately adopted this view and concluded that despite its potential pitfalls, peer review and publication are components of "good science" and should be considered. *Daubert*, 125 L. Ed. 2d at 483 (citing Arnold S. Relman and Marcia Augell, *How Good Is Peer Review?*, 321 *NEW ENG. J. MED.* 827 (1989)).

The Court, however, recognized inherent flaws when relying on publication and peer review. *Id.* Some argue that peer review stifles innovation by subjecting new hypotheses to such unnecessary scrutiny. David F. Horrobin, *The Philosophical Basis of Peer Review and the Suppression of Innovation*, 263 *J. AM. MED. ASS'N* 1425, 1438 (1990). Also, peer review cannot always expose scientific fraud. Drummond Rennie, *Editors and Auditors*, 261 *J. AM. MED. ASS'N* 2543, 2544 (1989). Similarly, the review may be limited by the quality of the reviewers. Daniel J. Capra, *Decision Unlikely to Have Real Impact on State or Federal Toxic Tort Litigation*, [Summer/Fall 1993] 21 *PRODUCT SAFETY & LIABILITY REP. (BNA)* No. 30, pt. II at 22, 25. And since publishing is an uncertain process, it may merely reflect an author's persistence and not the reliability of a particular theory. Kenneth J. Rothman, *Supreme Court Ruling Edges Courtroom Closer To Science*, [Summer/Fall 1993] 21 *PRODUCT SAFETY & LIABILITY REP. (BNA)* No. 30, pt. II at 26, 27.

<sup>64</sup> *Daubert*, 125 L. Ed. 2d at 483 (citing *United States v. Smith*, 869 F.2d 348, 353-54 (7th Cir. 1989)). In *Smith*, the court reviewed the error rates of spectrographic voice identification procedure. *Smith*, 869 F.2d at 354.

<sup>65</sup> *Daubert*, 125 L. Ed. 2d at 483. The Court noted that extensive recognition of methodology and scientific principles may be an important factor in determining admissibility. *Id.* Moreover, a principle which enjoys only marginal acceptance should be viewed with suspicion. *Id.*

stressed that the requirement remains the "general acceptance" of the underlying principles and not of the expert's resultant opinion.<sup>66</sup>

Chief Justice Rehnquist and Justice Stevens disagreed, in part, with the majority's analysis of the Federal Rules' requirements.<sup>67</sup> These Justices maintain that, *inter alia*, the majority extended the ruling to offer "abstract . . . general observations," regarding the Federal Rules without a factual controversy before the Court.<sup>68</sup> Additionally, these dissenting Justices stated that in setting forth the *Daubert* factors and defining such terms as "scientific knowledge," the majority addressed "matters far afield from the expertise of judges."<sup>69</sup>

### 3. *Federal Rules of Evidence, Rules 703 and 403*

The *Daubert* decision also requires trial courts to consider the admissibility of scientific expert opinion on the basis of additional Federal Rules of Evidence including Rules 703 and 403. Even if an expert is qualified to give an opinion under Rule 702, Rule 703 provides that the trial court must examine the source of the expert's opinion before it is presented to the jury.<sup>70</sup> If an expert relies on otherwise inadmissible hearsay,

---

<sup>66</sup> *Id.* This requirement was not initiated in *Daubert*. The Fifth Circuit and other circuits previously held that an expert's opinion need not be "generally accepted" within the scientific field to be sufficiently reliable. *Osburn v. Anchor Labs., Inc.*, 825 F.2d 908, 915 (5th Cir. 1987), *cert. denied*, 485 U.S. 1009 (1988); see *Peteet*, 868 F.2d at 1433 (stating methodology not opinion of expert must be generally accepted); *Wells v. Ortho Pharmaceutical Corp.*, 788 F.2d 741, 744-45 (11th Cir.) (noting importance of methodology not conclusion), *cert. denied*, 479 U.S. 950 (1986). The *Osburn* court further held that it was the acceptance of the methodology, not of the opinion, which determined admissibility. *Osburn*, 825 F.2d at 915.

<sup>67</sup> *Daubert*, 125 L. Ed. 2d at 486-87 (Rehnquist, C.J., concurring in part, dissenting in part).

<sup>68</sup> *Id.* (Rehnquist, C.J., concurring in part, dissenting in part).

<sup>69</sup> *Id.* (Rehnquist, C.J., concurring in part, dissenting in part). The justices also asserted that the majority committed grievous error by placing judges in the role of "amateur scientists." *Id.* (Rehnquist, C.J., concurring in part, dissenting in part).

<sup>70</sup> FED. R. EVID. 703 provides:

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or



the resultant opinion may be admitted only if the data and facts relied upon by the expert are of the type reasonably relied upon by other experts in the field.<sup>71</sup> The Fifth Circuit generally has held that issues regarding the facts and data relied upon by experts goes to the weight afforded the opinion evidence by the jury and not to admissibility.<sup>72</sup> However, where the source of the expert opinion is so unfounded that it renders the opinion unreliable, courts may use the facts and data analysis to hold the opinion inadmissible.<sup>73</sup>

Under *Daubert*, trial courts must also apply Federal Rule 403 as a screening device for otherwise admissible scientific evidence.<sup>74</sup> Rule 403 provides the trial court broad discretion to

---

data need not be admissible in evidence.

The Fifth Circuit in *Christophersen* extensively discussed the application of Rule 703. *Christophersen*, 939 F.2d at 1113. In that case plaintiff's expert relied primarily on inaccurate factual data from the deceased's co-worker's affidavit and facts which the expert embellished from the same affidavit. *Id.* The court of appeals approved of the trial court's close examination of the facts and data relied upon by plaintiff's expert. *Id.*

<sup>71</sup> FED. R. EVID. 703; see also *In re Paoli R.R. Yard PCB Litig.*, 916 F.2d 829, 856 (3d Cir. 1990) (stating review and reliance upon data must be recognized application in field), *cert. denied*, 499 U.S. 961 (1991). Courts may properly defer to the expert's opinion as to what sources others in the field may rely upon. *Greenwood Utils. Comm'n v. Mississippi Power Co.*, 751 F.2d 1484, 1495 (5th Cir.), *reh'g denied*, 757 F.2d 284 (1985).

<sup>72</sup> *Viterbo*, 826 F.2d at 422; see, e.g., *Osburn*, 825 F.2d at 915 (affirming jury verdict for plaintiffs and rejecting Rule 703 sufficiency challenge); *Thompson v. Southern Pacific Transp. Co.*, 809 F.2d 1167, 1169 (5th Cir.) (noting no discussion of Rule 703 regarding admissibility but reversing jury verdict for plaintiff where expert failed to provide sufficient evidence of causation), *cert. denied*, 484 U.S. 819 (1987).

<sup>73</sup> *Viterbo*, 826 F.2d at 422. Thus, the court is obliged to determine the reliability of the expert's source of data to determine whether it is sufficient to satisfy Rule 703. *Soden v. Freightliner Corp.*, 714 F.2d 498, 502 (5th Cir. 1983); see *Washington v. Armstrong World Indus., Inc.*, 839 F.2d 1121, 1123 (5th Cir. 1988) (expert's testimony inadmissible because pure speculation based upon negative inference drawn from testimony of three treating physicians); *Barrel of Fun, Inc. v. State Farm Fire & Casualty Co.*, 739 F.2d 1028, 1033 (5th Cir. 1984) (noting court must look at facts and data utilized by expert to see if type reasonably relied upon in their field).

<sup>74</sup> FED. R. EVID. 403 provides:

Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.

exclude otherwise admissible evidence if the danger of unfair prejudice outweighs its probative value or it misleads the jury.<sup>75</sup> If a trial court determines that the proffered opinion is not supported by reliable sources, then the opinion may be held to be more prejudicial than probative and should be excluded.<sup>76</sup>

The danger that evidence will have an unfairly prejudicial effect is heightened when dealing with expert opinion.<sup>77</sup> Juries tend to be awed by experts and to place significant emphasis on their testimony when the evidence presented may not warrant such weight.<sup>78</sup> Thus, the Supreme Court directed trial courts to determine the admissibility of scientific expert testimony by focusing on Rules 403 and 703, in addition to Rules 104(a) and 702.<sup>79</sup>

<sup>75</sup> FED. R. EVID. 403; see *United States v. Edelman*, 873 F.2d 791, 795 (5th Cir. 1989) (ruling linguistics expert offered to prove defendant not involved in conspiracy excluded because danger of unfair prejudice and misleading jury); *Barrel of Fun, Inc.*, 739 F.2d at 1033 (holding that in insurance fraud case, expert testimony based on psychological stress evaluation was inherently suspect and highly prejudicial).

<sup>76</sup> *Viterbo*, 826 F.2d at 422. In that case, plaintiff's expert attempted to offer an opinion of causation between the exposure to herbicide and plaintiff's physical and emotional infirmities. *Id.* The expert relied erroneously on the oral medical history of plaintiff. *Id.* at 423. Although these records are generally held to be reliable, the history relied upon by plaintiff's expert was not reliable because the expert was not aware of the history of hypertension in plaintiff's family. *Id.* Plaintiff's expert also relied on tests the expert conducted. *Id.* While these tests showed that plaintiff suffered from some sort of toxic reaction, the results did not implicate the chemical manufacture by the defendants. *Id.* The court held that these deficiencies in the expert's sources rendered his opinion unreliable, irrelevant and thus inadmissible. *Id.* at 424.

<sup>77</sup> The *Daubert* Court noted that expert evidence can be highly persuasive and possibly misleading because of the difficulty in analyzing it. *Id.*

<sup>78</sup> *Downing*, 753 F.2d at 1235; see also *United States v. Amaral*, 488 F.2d 1148, 1152 (9th Cir. 1973) (stating that juries view experts with "aura of special reliability and trustworthiness"); *Addison*, 498 F.2d at 744 (noting scientific testimony may "assume . . . posture of mythic infallibility" when presented to lay jury).

<sup>79</sup> *Daubert*, 125 L. Ed. 2d at 484. The Court also stated that Rule 706 enables courts to enlist the assistance of a court selected expert to resolve questions of admissibility of proffered scientific testimony. *Id.* Even when exercising the Rule 706 option to enlist the assistance of a court appointed expert, courts must still subject them to the same evaluation of credibility as any other witness. *DeAngelis v. Tarricone, Inc.*, 151 F.R.D. 245, 245 (S.D.N.Y. 1993); see *In re Joint Eastern and Southern Districts Asbestos Litig. v. Blinks*, 151 F.R.D. 540, 543 (E. & S.D.N.Y. 1993) (applying post-

*C. The Court's Focus on Conventional Safeguards in  
Litigation*

The Court found no merit in respondent's argument that rejection of the "general acceptance" standard would result in a "free-for-all" where juries would be bombarded with unfounded hypotheses.<sup>80</sup> Specifically, the Court emphasized the capabilities of the jury and the adversarial system in general.<sup>81</sup> The Court observed that cross-examination, presentation of contrary evidence, and precise jury instructions on the burden of proof, were adequate to expose questionable expert opinion.<sup>82</sup> In addition, the Court noted that Federal Rules of Civil Procedure 50(a), directed verdict, and 56, motions for summary judgment, were available to challenge an opponent's case relying upon scientific expert opinion.<sup>83</sup>

IV. THE IMPACT OF *DAUBERT*

*A. The Role of the Judiciary*

*Daubert* emphasizes the trial court's gatekeeper role and the judge's broad discretion to determine the admissibility of scientific evidence. This expansion will undoubtedly increase the emphasis on pretrial practice. The *Daubert* Court essentially mandates a Rule 104(a) hearing to examine the proffered scientific evidence in light of the admissibility factors articulated by the Court. Therefore, practitioners should now focus on pretrial challenges to proffered experts by motions for Rule 104 hearings, motions in limine, and motions for summary judgment.<sup>84</sup>

---

*Daubert* analysis to Rule 706 expert).

<sup>80</sup> *Daubert*, 125 L. Ed. 2d at 484.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* (citing *Rock v. Arkansas*, 483 U.S. 44, 61 (1987)).

<sup>83</sup> *Id.* (citing *Brock*, 874 F.2d at 309; *Turpin v. Merrell Dow Pharmaceuticals, Inc.*, 959 F.2d 1349, 1352 (6th Cir. 1992), *cert. denied*, 506 U.S. \_\_\_, 121 L. Ed. 2d 47 (1992)).

<sup>84</sup> The Northern District of Alabama already encourages such use of pretrial procedures and pretrial orders. An example of such a pretrial order is as follows:

Within two weeks after the close of discovery, all parties are to file with the court summaries of the testimony to be given by any experts to be used at



### 1. *Use Discovery to Begin the Daubert Examinations*

The increased possibility of excluding or limiting an adverse witness as a result of *Daubert* requires the litigator to begin preparation with the filing of written discovery during the self-executing discovery phase of Federal Rule of Civil Procedure 26, effective December 1993.<sup>85</sup> Where appropriate, requests for admissions can be used, but the most important discovery device is the expert witness deposition.

The careful attorney should first analyze the factors articulated by the *Daubert* Court in light of the issues in the case at hand. This analysis can serve as the first layer in the foundation on which to base a challenge against the opposing expert.<sup>86</sup> From this analysis, a deposition outline should be prepared that will insure interrogation of the opposing expert on each factor. The deposition should also cover Federal Rules 702, 703, and 403 issues which are relative to the case. This deposition can then serve as the basis for any of the motions discussed below.

---

trial. Such summaries must include all conclusions and all reasoning supporting conclusion, including the scientific or professional theories or standards relied upon. These summaries may take the form of submitting copies of all reports submitted by the expert to the party hiring him, if they constitute a fair summary as aforesaid. At the time the court will determine the necessity of a court appointed expert pursuant to Rule 706, Federal Rules of Evidence. Failure on the part of any party to file said summaries will be grounds for forfeiture of that party's right to use expert testimony at trial.

David E. Bernstein & Peter W. Huber, *'Daubert' Plaintiffs Won Technical Battle But Plainly Lost the War*, [Summer/Fall 1993] 21 PRODUCT SAFETY & LIABILITY REP. (BNA) No. 30, pt. II at 16, 17. (citing Judge J. Foy Guin, Jr. of the United States District Court for the Northern District of Alabama).

<sup>85</sup> FED. R. CIV. P. 26 (as amended 1993).

<sup>86</sup> Anne E. Cohen, *Impact Of Ruling Will Depend On Weight Courts Give To 'Reliability Factors'*, [Summer/Fall 1993] 21 PRODUCT SAFETY & LIABILITY REP. (BNA) No. 30, pt. II at 36, 36. Laying this foundation may require consultations with your own experts and others in the field about the "reliability" of the proposed testimony. J. Thomas M. Reavley, *'Daubert' May Be Read To Allow Broad Judicial Control In Evaluating Reliability*, [Summer/Fall 1993] 21 PRODUCT SAFETY & LIABILITY REP. (BNA) No. 30, pt. II at 19, 20. These considerations also work in the converse manner, i.e., prepare and select your own witnesses with the *Daubert* factors in mind.

Equally important is the preparation of friendly experts before defending their depositions. This preparation includes a review of the same *Daubert* factors and a discussion of the expert's qualifications to interpret the relevant data.<sup>87</sup> Selection of a friendly expert should no longer be based solely on credentials or presence as a witness. Consideration must be given to the reliability of the expert's source of data, the methodology used by the expert, and the validation of this method.<sup>88</sup>

## 2. Federal Rule 702

Federal Rule 702 remains a viable option for attacking proffered expert testimony. Opponents may challenge the relevancy of the proffered evidence. Specifically, opponents may argue that the methods applied by the expert were unreliable<sup>89</sup> and that the resultant opinion is not sufficiently tied to the facts at issue.<sup>90</sup> These arguments may be especially well

---

<sup>87</sup> Michael Ciresi & Martha Wivell, *Countering Junk Law Tactics*, 27 TRIAL 38, 38 (Nov. 1991). Ciresi and Wivell advise their attorneys to have their expert testify that his or her analysis of the raw data is typically relied upon by members of the relevant scientific community. *Id.* Furthermore, the authors suggest showing that the expert has testified in other proceedings using the same techniques. *Id.* Additionally, a second expert should review the first expert's techniques and provide affidavits that the first expert's methodology is generally applied by experts in the field. *Id.*

<sup>88</sup> This evaluation may involve increasing the time practitioners spend reviewing experts prior to retaining them. Moreover, this consideration may require that experts not only focus on the factors involved in a particular case, but devote time focusing on specific flaws in the methodology of the opposing expert's scientific evidence.

<sup>89</sup> Since *Daubert*, the Eighth Circuit Court of Appeals has addressed such challenges in *United States v. Martinez*, 3 F.3d 1191 (8th Cir. 1993), *cert. denied*, 114 S. Ct. 734 (1994). The *Martinez* court affirmed defendant's conviction of aggravated sexual assault of a minor and reaffirmed its judicial notice of the reliability of DNA profiling. *Martinez*, 3 F.3d at 1197-99. However, such expert testimony will not be admissible without further inquiry into the reliability of the techniques involved in creating the profiles. *Id.* at 1197-98. The court mandated a preliminary showing that the expert derived the testimony from the application of reliable methodology in the particular case at issue. *Id.* The fact that a prior application of such techniques was found reliable in other cases was not sufficient. *Id.*

<sup>90</sup> The Fifth Circuit has specifically addressed these post-*Daubert* arguments. *Marcel v. Placid Oil Co.*, No. 91-3788, 1994 WL 604 (5th Cir. Jan. 14, 1994). The *Marcel* court affirmed the exclusion of testimony by plaintiff's expert in a workers' compensation action. *Id.* at \*3. Plaintiff's expert economist proposed to testify about

received because courts are more familiar with relevancy considerations than with evaluating scientific evidence for validity and reliability.<sup>91</sup>

The *Daubert* factors also provide considerations that both the proponent and opponent of scientific expert opinion should contemplate.<sup>92</sup> The "general acceptance" standard remains one of the elements considered under Rule 702 and should still be evaluated before an expert's opinion is admitted. Therefore, these arguments used before *Daubert* are still applicable under the new standard.<sup>93</sup>

One of the stronger Rule 702 challenges rests in the qualifications of the proffered expert. Opponents of proffered experts should argue that the expert lacks the requisite credentials, and that the expert is not qualified to give an opinion in the particular area which is at issue.<sup>94</sup>

the work-life expectancy of an oil field worker based on a published study. *Id.* Defendants objected on two grounds: (1) the expert did not relate the study to the specific facts to the case at issue; and (2) the underlying study was unreliable. *Id.* The *Marcel* court held that the expert's opinion was not sufficiently rooted in the facts of the case, and thus, the testimony would not assist the trier of fact. *Id.* at \*4.

<sup>91</sup> Cohen, *supra* note 86, at 37.

<sup>92</sup> Peer review may be considered a strong factor in the Fifth Circuit. In the case of *In re Air Crash*, the court observed that many experts were consultants supplementing their academic salaries. *In re Air Crash*, 795 F.2d at 1234. The Fifth Circuit also took judicial notice that many of these experts provided opinions and studies that they would not submit to peer reviewed journals. *Id.* Thus, to properly evaluate proffered expert testimony, courts should continue to look to peer review as an important consideration. *Id.*

<sup>93</sup> Opponents of expert testimony should argue that the expert did not use well-founded methodology which was generally accepted within the requisite scientific community. *Christophersen*, 939 F.2d at 1111. However, under *Daubert*, the focus is upon the methodology, not the conclusion reached by the expert. *Daubert*, 125 L. Ed. 2d at 484; *see also Osburn*, 825 F.2d at 915 (stating expert opinion need not be generally accepted before such opinion may be admissible). While the Fifth Circuit relied on *Frye* for the "general acceptance" standard, other courts had already interpreted Rule 702 to incorporate such a requirement. *Sterling v. Velsicol Chem. Corp.*, 855 F.2d 1188, 1208 (6th Cir. 1988) (holding that Rule 702 requires that principles supporting scientific evidence must be sufficiently accepted in relevant field).

<sup>94</sup> *Sullivan v. Rowan Cos.*, 952 F.2d 141, 146 (5th Cir. 1992). In *Sullivan*, the Fifth Circuit affirmed a "j.n.o.v." in favor of the defendants. *Id.* at 145. Plaintiff offered an expert in metallurgical failure analysis who had performed approximately 1,500 failure analyses involving metals. *Id.* The *Sullivan* court, however, held that despite the expert's experience in the field, he had no engineering background nor any education



### 3. Federal Rule 703

Following *Daubert*, practitioners may still rely on Federal Rule 703 to argue that an expert's opinion is inadmissible because he or she relied on facts or data which are not reasonably relied upon by other experts in the field.<sup>95</sup> For example, in the case of *In re Agent Orange*, Vietnam veterans attempted to offer expert testimony that they suffered detrimental health effects as a result of their exposure to Agent Orange.<sup>96</sup> The *Agent Orange* court excluded the proffered opinions because they were based on unreliable and insufficient data.<sup>97</sup> Specifically, the court excluded two expert opinions because the experts based their conclusion of causation upon hearsay checklists and affidavits provided by the litigants without any corroborating medical records or tests.<sup>98</sup> Although patients' statements may be relied upon by other medical experts in the field, no expert reasonably draws a causal link between exposure and disease absent additional studies and personal examinations of the patients.<sup>99</sup>

---

in the field; and thus, the court held the expert was unqualified to give an opinion in this area. *Id.* at 146; see *Benavides v. County of Wilson*, 955 F.2d 968, 973 (5th Cir.) (affirming summary judgment for defendants, holding, *inter alia*, plaintiff's expert testimony inadmissible because qualifications were never presented and testimony lacked sufficient factual basis), *cert. denied*, 121 L. Ed. 2d 43 (1992). *Perkins v. Volkswagen of Am., Inc.* 596 F.2d 681, 682 (5th Cir. 1979) (affirming exclusion of testimony where witness was specialist in mechanical engineering but had no experience with designing entire automobiles). *But see Ellis v. K. Lan Co., Inc.*, 695 F.2d 157, 161 (5th Cir. 1983) (holding witness qualified to give expert testimony about defectiveness of product even though unfamiliar with regulatory standards or definitions concerning that product).

<sup>95</sup> FED. R. EVID. 703. This Rule 703 argument is available only where the facts and data relied upon are not independently admissible. *Id.*

<sup>96</sup> *In re Agent Orange*, 611 F. Supp. at 1242.

<sup>97</sup> *Id.* The *Agent Orange* court ultimately granted summary judgment for seven defendant chemical companies because there was no proof of causation. *Id.*

<sup>98</sup> *Id.* at 1247. The court noted that these experts did not assert that they normally relied on such hearsay checklists in drawing conclusions about the cause of their patient's illnesses. *Id.* at 1246. Moreover, these general checklists were self-serving for the litigants, and provided no details regarding the extent of exposure to Agent Orange. *Id.*

<sup>99</sup> *Id.*

Courts generally interpret Federal Rule 703 using one of two approaches.<sup>100</sup> The more restrictive view requires the trial court not only to determine whether the facts and data were reasonably relied upon, but also to consider whether the underlying sources were untrustworthy for hearsay or other reasons.<sup>101</sup> The Fifth Circuit subscribes to this view.<sup>102</sup> The more lenient view, however, does not require a separate determination of the trustworthiness of the underlying sources.<sup>103</sup>

#### 4. Federal Rule 403

Similarly, opponents of an offered expert should argue that the scientific evidence should be excluded as lacking sufficient probative value pursuant to Federal Rule 403.<sup>104</sup> This argu-

---

<sup>100</sup> *Id.* at 1243-44.

<sup>101</sup> *In re Agent Orange*, 611 F. Supp. at 1243-44. The *Agent Orange* court noted that trustworthiness may be established if the data relied upon is that which is reasonably relied upon by other experts. *Id.* at 1244. This contention stems from the fact that where an expert is otherwise qualified under Rule 702, he or she is presumed to have the skill to correctly evaluate the bases for the resultant opinion. *Id.* Even with this deference, the restrictive view requires courts to examine the reliability of the methodology connecting the data to the facts and to not limit its review only to the facts and data itself. *Id.*

<sup>102</sup> *Soden*, 714 F.2d at 505; see *Christophersen*, 939 F.2d at 1113 (requiring courts to look beyond facts and data, and examine methodology applied to connect such to facts of case). Courts making this inquiry must give the appropriate deference to the jury's role in assessing the weight of the evidence. *Poller v. Columbia Broadcasting Systems, Inc.*, 368 U.S. 464, 473 (1962); see *Viterbo*, 826 F.2d at 422 (citing favorably *In re Agent Orange* which subscribes to restrictive view and stating that court should be mindful of jury's role).

<sup>103</sup> *In re Japanese Elec. Prods. Anti-trust Litig.*, 723 F.2d 238, 276 (3d Cir. 1983), *rev'd on other grounds sub nom.*, *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

<sup>104</sup> *Bernstein & Huber*, *supra* note 84, at 17. An example of questionable probative value may be found in *Daubert* itself. Although the plaintiffs' experts' opinions were based on supporting evidence, these experts virtually ignored the thirty published epidemiological studies which undermined their theory. *Daubert*, 125 L. Ed. 2d at 476. The unaccepted methodology of non-peer reviewed re-analysis is the core of the admissibility issue in *Daubert* on remand. Moreover, the potential for prejudicial effects of the epidemiological re-analysis utilized in *Daubert* may be seen in the jury awards of similar cases and the subsequent judicial remedies applied. See generally *Ealy v. Richardson-Merrell*, 897 F.2d 1159, 1163 (D.C. Cir.), *cert. denied*, 498 U.S. 950 (1990) (100 million dollar jury verdict set aside on appeal pursuant to Rule 403); *Richardson*,

ment is particularly strong where an expert relied on methodology which is not accepted in science.<sup>105</sup>

### B. Procedures for Raising These Daubert Challenges

#### 1. Federal Rule 104(a) Hearing

The Federal Rule 104(a) procedure has received the most attention in *Daubert*, but it was used in many jurisdictions prior to *Daubert*. Since the time of judges is so limited, it might be more difficult to prevail upon a busy trial judge to conduct a hearing in all but the most complex of cases. But, the very fact that such a hearing is available under the Federal Rules can frequently serve as an inducement to the judge to entertain the issues through written submissions in lieu of a hearing with testimony.

The best example of an extensive Federal Rule 104(a) hearing is that conducted by the *In re Paoli* trial court following remand from the Court of Appeals for the Third Circuit.<sup>106</sup> In that case, plaintiffs alleged that the development of their various illnesses resulted from their alleged exposure to polychlorinated biphenyls (PCBs) while they either worked or lived near the Paoli Railroad Yard.<sup>107</sup> Upon remand, defendants filed numerous motions in limine seeking to exclude plaintiffs' experts. The trial court conducted numerous hearings in which all parties were permitted to present witnesses and exhibits in support of or in response to the

---

857 F.2d at 825 (1.6 million dollar plaintiff's verdict rejected on "j.n.o.v.").

<sup>105</sup> *In re Agent Orange*, 611 F. Supp. at 1247.

<sup>106</sup> *In re Paoli*, Nos. 86-2229; 86-2235; 86-7561; 87-1258; and 87-5269, 1992 WL 321226 (E.D. Pa. Oct. 21, 1992). On September 20, 1990, the Third Circuit reversed the trial court's granting of Defendants' motions for summary judgement. *In re Paoli*, 916 F.2d at 836. The Third Circuit held, *inter alia*, that the trial court erred in applying an overly stringent standard to the qualification of experts pursuant to Federal Rule 702. *Id.* The court also erred in applying the *Downing* test and factors. *Id.*; see *supra* notes 42-45 and accompanying text.

<sup>107</sup> *Id.* at \*1. PCBs were used in the transformers of the Paoli rail cars. *Id.* They were also found in heightened levels in the soil and air surrounding the rail yard at issue. *Id.*



motions.<sup>108</sup> With regard to all of the motions filed, the trial court made specific findings of facts and conclusions of law based on the Federal Rules.<sup>109</sup> The trial court, pursuant to Rule 702, examined the methodology utilized by plaintiffs' expert.<sup>110</sup> In excluding the expert's opinion, the court held that the expert's methodology was unreliable and had not been subjected to peer scientific scrutiny.<sup>111</sup> Thus, an opinion grounded on such a flawed basis would not assist the trier of fact.<sup>112</sup> Next, the trial court, pursuant to Federal Rule 703, examined the underlying data relied upon by plaintiffs' experts and held that this too was unreliable.<sup>113</sup> The trial court thus held a Federal Rule 104(a) hearing, and engaged in detailed analysis of the reliability and bases of proffered expert opinion prior to letting the testimony go to the jury. Such a detailed hearing is the type of examination mandated by *Daubert*.

## 2. Motions in Limine

Although the Federal Rules of Evidence do not specifically address motions in limine, Federal Rule of Civil Procedure 16, governing pretrial procedures, implies their use.<sup>114</sup> Additionally, these motions are proper given that Federal Rule 104

---

<sup>108</sup> *Id.*

<sup>109</sup> See *Id.* 1992 WL 321226, at \*15 (listing conclusions of each hearing); *In re Paoli*, Nos. 86-2229; 86-7414 through 86-7420, 1992 WL 323512, at \*14) (making similar listings of hearing conclusions).

<sup>110</sup> *In re Paoli*, 1992 WL 321226, at \*15-16. Specifically, the trial court noted that the reliability inquiry must be flexible; yet not so malleable as to admit unreliable evidence. *Id.* at \*15. Plaintiffs' expert relied on the methodology of recalculating plaintiffs' test results by a "correction factor based upon three values obtained in a split sample test in 1986." *Id.* Defendants' expert testified that no reasonable scientist in the field of exposure or risk assessment would rely on such recalculations to reach a conclusion of causation. *Id.* The court went on to discuss other false assumptions upon which Plaintiffs' expert relied and how these also weighed against admissibility. *Id.* at \*16-19.

<sup>111</sup> *Id.* at \*18.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* at \*19.

<sup>114</sup> FED. R. CIV. P. 16.

provides that trial judges must make preliminary rulings regarding admissibility of evidence.<sup>115</sup>

A motion would call the court's attention to the reasons why an expert or his or her opinions should be excluded. Such a motion should be based on carefully taken depositions of opposition experts, affidavits or depositions from movant's experts, written discovery responses and, if appropriate, requests for admissions. A strong motion might lead to a Federal Rule 104 hearing. If the motion in limine to exclude evidence is denied, the movant must renew the objection whenever the evidence is offered at trial.<sup>116</sup> This renewal offers the trial judge another opportunity to consider the previous ruling within the context of the trial.<sup>117</sup>

Where the motion in limine is granted, however, the party against whom the motion was granted must make an offer of proof at trial to preserve the right to appeal.<sup>118</sup> Although this offer of proof should be made when the evidence would have been presented, it may be made at the close of the witness' testimony. Additionally, the offer of proof must be made outside the hearing of the jury.<sup>119</sup>

### 3. *Motions for Summary Judgment*

*Daubert* emphasizes that trial judges must continue to grant Federal Rule of Civil Procedure 56 motions for summary judgment where the evidence presented is insufficient for a reasonable juror to base his or her findings.<sup>120</sup> Thus, for

---

<sup>115</sup> FED. R. EVID. 104(a) and Official Comment.

<sup>116</sup> *Collins v. Wayne Corp.*, 621 F.2d 777, 784 (5th Cir. 1980); see *Petty v. Ideco, Div. of Dresser Indus., Inc.*, 761 F.2d 1146, 1150 (5th Cir. 1985) (stating that in order to preserve error for appellate review, movant, whose motion in limine has been denied, must renew objections at trial).

<sup>117</sup> *Fusco v. General Motors Corp.*, No. 93-2473, 93-1801, 1993 WL 494155, at \*3 (1st Cir. Dec. 6, 1993).

<sup>118</sup> *Potts v. Benjamin*, 882 F.2d 1320, 1325 (8th Cir. 1989) (citing FED. R. EVID. 103(a)(2)).

<sup>119</sup> *Id.*

<sup>120</sup> *Daubert*, 125 L. Ed. 2d at 484-85. The Supreme Court addressed respondents' contention that the abandonment of the "general acceptance" theory would allow virtually all evidence to go to the jury. *Id.* The Court concluded that the conventional

example, where scientific expert opinion is based on unreliable or unsound data or methodology, it does not create an issue of material fact sufficient to deny summary judgment.<sup>121</sup> Therefore, motions for summary judgment supported by affidavits and expert witness depositions should be used where possible.

#### V. *DAUBERT'S* POTENTIAL EFFECT ON MISSISSIPPI STATE COURTS

The Supreme Court of Mississippi has not yet ruled on what effect, if any, *Daubert* has on the standard of admissibility of scientific evidence in Mississippi state courts. However, the Mississippi Supreme Court may be persuaded to follow the guidelines set forth in *Daubert*<sup>122</sup> because the Mississippi Rules of Evidence (Mississippi Rules) are modeled after the Federal Rules,<sup>123</sup> Notably, since the Mississippi Rules were adopted by the Mississippi Supreme Court<sup>124</sup> rather than the

---

devices were sufficient to protect against this occurrence. *Id.* at 485.

<sup>121</sup> *Viterbo*, 826 F.2d at 422; see *Washington*, 839 F.2d at 1123. In *Washington*, plaintiff filed suit against defendant manufacturers of asbestos. *Id.* at 1122. Plaintiffs alleged that her husband's death was caused by occupational exposure to asbestos. *Id.* Defendant filed a motion for summary judgment supported by affidavits by physicians testifying that there was no evidence that asbestos exposure caused decedent's colon cancer. *Id.* Plaintiff proffered an expert who had never interviewed nor treated the decedent, but nevertheless concluded that his cancer was caused by exposure to defendants' asbestos. *Id.* The Fifth Circuit affirmed the trial court's exclusion of the plaintiffs' expert testimony because such testimony was unreliable. *Id.* at 1123. The appellate court further held that without expert testimony, plaintiff failed to carry her burden of proof to meet an essential element of her case; thus the court granted defendant's motion. *Id.* (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 123 (1986)).

<sup>122</sup> Such arguments have been made in Delaware, Louisiana, and West Virginia. See *Nelson v. State*, 628 A.2d 69, 73 (Del. 1993) (holding that Delaware Rules of Evidence were modeled after Federal Rules, thus court to follow *Daubert*); *Louisiana v. Foret*, No. 93-K-0246, 1993 WL 491983, \*4-6 (La. Dec. 1, 1993) (analyzing *Daubert* and adopting factors as guidelines to be applied in state courts); *Wilt v. Buracker*, No. 21708, 1993 WL 517042, \*3-4 (W. Va. Dec. 13, 1993) (stating court previously recognized *Frye* but post-*Daubert* will apply factors).

<sup>123</sup> *Goodson v. State*, 566 So. 2d 1142, 1145 (Miss. 1990).

<sup>124</sup> By order of September 24, 1985, the Mississippi Supreme Court adopted the Mississippi Rules of Evidence (Mississippi Rules) to be effective January 1, 1986. Order Adopting Mississippi Rules of Evidence, Sept. 24, 1985, Staton, Ellis and Williams, Mississippi Rules of Court at 220-21 (1991). In doing so, the court exercised its inherent rule making authority to regulate practice and procedure within the Judicial



legislature, the court may look to its own intent and previous case law to interpret the rules that the court adopted.<sup>125</sup> Thus, the careful practitioner should continue to utilize pre-*Daubert* state cases in preparing to present or to contest expert witness testimony. Counsel should, however, expect and insist that the state trial court take a much more active role out of the presence of the jury in determining what expert opinions will be heard by juries.

#### A. *Mississippi Rule of Evidence 702*

Mississippi Rule 702 is virtually identical to Federal Rule 702.<sup>126</sup> Thus, Mississippi Rule 702 requires the trial court to make the determination of whether the proffered expert testimony will assist the trier of fact and whether the expert is qualified to give an opinion.<sup>127</sup> In state court, however, the trial judge must first determine whether the opinion is in a field of expertise where it has been proven that investigation

---

Branch. *Mitchell v. State*, 539 So. 2d 1366, 1371 (Miss. 1989). Such authority of the Mississippi Supreme Court was first recognized in *Newell v. State*, 308 So. 2d 71, 76 (Miss. 1975). *Newell* was a criminal case in which neither party provided jury instructions regarding the essential elements of the crime charged against the defendant. *Newell*, 308 So. 2d at 74. The Mississippi Code provides that these instructions must be given by the parties, and not by the judge. *Id.* (citing MISS. CODE. ANN. § 11-7-155 (1972)). Despite the Mississippi statute, the Mississippi Supreme Court, *sua sponte*, found that the framers of the State Constitution instilled in the judiciary the inherent powers "to prescribe rules of procedure to facilitate justice . . . ." *Newell*, 308 So. 2d at 77 (citing MISS. CONST. art. I, §§ 1, 2, 144, 146, 155).

<sup>125</sup> See *Arizona v. Bible*, 858 P.2d 1152, 1183 (Az. 1993) (en banc). The Arizona Supreme Court did not make a final determination of whether to modify, abolish or to continue its strict application of *Frye*. *Id.* The court noted that *Bible* involved DNA testing which was deemed a difficult scientific technology upon which to base a new standard of admissibility. *Id.*

<sup>126</sup> *Goodson*, 566 So. 2d at 1145. The Official Comment to Mississippi Rule 702 specifically states that Mississippi Rule 702 does not "relax the requirement that the scientific principle from which the expert's opinion is derived 'must be sufficiently established to have gained 'general acceptance' in the particular field to which it belongs.'" *Id.* (quoting *Frye*, 293 F. at 1014).

<sup>127</sup> *Hardy v. Brantley*, 471 So. 2d 358, 366 (Miss. 1985). More specifically, the trial court must determine whether the expert witness possesses knowledge which is not presumably held by a lay person. *Goodson*, 566 So. 2d at 1145 (citing *Detroit Marine Eng'g v. McRee*, 510 So. 2d 462, 467 (Miss. 1987)).

will yield a valid result.<sup>128</sup> Child sexual abuse cases in Mississippi are an example of how this issue arises at the trial level. There is no scientifically established child sexual abuse profile to assist physicians or courts in conclusively determining whether a child has been sexually abused.<sup>129</sup> Moreover, there is strong disagreement among experts on the characteristics of sexual abuse.<sup>130</sup> Therefore, in Mississippi, expert testimony should not be admitted regarding the characteristics of child sexual abuse. Other courts and commentators also agree that expert opinion testimony supporting the theory that a child demonstrates the characteristics of other abuse victims is inadmissible.<sup>131</sup>

Pursuant to Mississippi Rule 702, trial courts must determine whether the witness is qualified to give opinion testimony.<sup>132</sup> The trial court has wide discretion to make this

<sup>128</sup> *Goodson*, 566 So. 2d at 1146. Specifically, the court must inquire, "Is the field of expertise one in which it has been scientifically established that due investigation and study in conformity with techniques and practices generally accepted within the field will produce a valid opinion?" *Hosford v. State*, 560 So. 2d 163, 168 (Miss. 1990) (quoting *House v. State*, 445 So. 2d 815, 822 (Miss. 1984)); see also *Mississippi Farm Bureau Ins. Co. v. Garrett*, 487 So. 2d 1320, 1326 (Miss. 1986). Although this criteria arises from a pre-1986 case, the Official Comment to Mississippi Rule 702 specifically cites to this standard. The Comment notes that the adoption of Mississippi Rule 702 was not meant to relax the requirement that an expert's opinion must stem from scientific principles which are generally accepted within requisite scientific field. Official Comment MISS. R. EVID. 702 (citing *Frye*, 239 F. at 1014).

<sup>129</sup> *Goodson*, 566 So. 2d at 1146.

<sup>130</sup> *Myers et al., Expert Testimony in Child Sexual Abuse Litigation*, 68 NEB. L. REV. 1, 85 (1989).

<sup>131</sup> *Hosford*, 560 So. 2d at 168. In *Hosford*, the Mississippi Supreme Court held that the trial court improperly admitted the plaintiffs expert testimony regarding the characteristics of child sexual abuse. *Id.* This error was held harmless, however, and the defendant's conviction was not overturned. *Id.* The court held the error as harmless because the defense was not that the child had not been abused, but rather that the abuse was committed by someone other than the defendant. *Id.*

Some jurisdictions ban expert testimony in child sexual abuse cases. See, e.g., *State v. Black*, 537 A.2d 1154, 1157 (Me. 1988); *Johnson v. State*, 732 S.W.2d 817, 821 (Ark. 1987); *State v. Lash*, 699 P.2d 49, 50-51 (Kan. 1985); *State v. Haseltine*, 352 N.W.2d 673, 676 (Wis. 1984); *State v. Catore*, 435 A.2d 321, 326 (R.I. 1981). Other jurisdictions, however, allow such testimony. See, e.g., *Glendening v. State*, 536 So. 2d 212 (Fla. 1988), cert. denied, 492 U.S. 907 (1989); *Townsend v. State*, 734 P.2d 705 (Nev. 1987).

<sup>132</sup> *Hall*, 466 So. 2d at 873; see also *Pharr*, 436 So. 2d at 1359 (stating expert must be qualified in order to give opinion). The Mississippi Supreme Court also reasoned

determination.<sup>133</sup> The court must first look to the proffered expert's actual qualifications and must find that he or she is specially trained in the area about which they will testify.<sup>134</sup> The Mississippi Supreme Court addressed this issue in the medical malpractice case of *Palmer v. Biloxi Regional Medical Center, Inc.*<sup>135</sup> The court affirmed the trial court's exclusion of plaintiff's proffered medical expert.<sup>136</sup> Although the proffered expert was a licensed surgeon, the court found that the expert was not qualified to offer an opinion on the issues that were the subject of the case. Further, the court found that the expert was not familiar with the medical status of the deceased, nor did he have a working knowledge of the facilities available

---

that before the testimony may "assist the trier of fact" the witness must be a qualified expert to give evidence in a particular field. *Goforth v. City of Ridgeland*, 603 So. 2d 323, 329 (Miss. 1992).

<sup>133</sup> *Goodson*, 566 So. 2d at 1145 (citing *May*, 524 So. 2d at 963). The trial court is afforded wide discretion in making the qualification determination. *Dixon v. International Harvester Co.*, 754 F.2d 573, 579 (5th Cir. 1985); see also *Poirrier v. Degrande*, 604 So. 2d 268, 270 (Miss. 1992) (ruling qualification determination left to sound discretion of trial judge); *Wyeth Lab., Inc. v. Fortenberry*, 530 So. 2d 688, 690 (Miss. 1988) (noting that qualifications of proffered witness is within trial court's discretion). The trial court's determination will only be reversed where there is an abuse of discretion. *Goforth*, 603 So. 2d at 329. See, e.g., *Thornhill v. State*, 561 So. 2d 1025, 1032-33 (Miss. 1989) (stating trial court's ruling stands, absent abuse of discretion); *Detroit Marine Eng'g v. McRee*, 510 So. 2d 462, 467 (Miss. 1987) (affirming admissibility of expert opinion testimony as trial court held expert qualified).

<sup>134</sup> The *Goforth* court stated that "Rule 702 prescribes no free-floating test of expertise." *Goforth*, 603 So. 2d at 329. Therefore, an expert's knowledge may not "assist the trier of fact" unless that expert possesses specialized training regarding the matter at issue. *Id.*; see also *Parmes v. Illinois Cent. Gulf R.R.*, 440 So. 2d 261, 262 (Miss. 1983) (affirming exclusion of witness although generally qualified as engineer had no familiarity with design of traffic lights at issue).

<sup>135</sup> 564 So. 2d 1346 (Miss. 1990).

<sup>136</sup> *Palmer*, 564 So. 2d at 1357. In this case, parents of the deceased brought a medical malpractice action against the Biloxi Regional Medical Center and an oral surgeon after their daughter died following emergency medical procedures. *Id.* at 1350. Plaintiffs' retained Dr. Lampier to review the procedures of the defendants and to testify as an expert in the litigation. *Id.* at 1352. Lampier was a licensed surgeon in Massachusetts and New Hampshire and belonged to the "Medical, Legal, Malpractice Peer Review Foundation." *Id.* at 1358. The court noted, however, that Lampier created the Foundation and was the sole member. *Id.*



to the defendant surgeon during treatment of the deceased.<sup>137</sup> Therefore, where an expert is to be used to offer an opinion regarding a specific issue, it is imperative that the expert be specially educated and trained in that field and not merely be a generally licensed practitioner.<sup>138</sup>

An important corollary to that rule is that an expert's qualifications in one area do not necessarily qualify that expert to offer an opinion in another area. Thus, an expert, qualified to give a medical opinion based on his or her examination of a party, may not be qualified to give evidence as to the psychological state of the party absent an additional showing of the expert's training in the field of psychology.<sup>139</sup> Even if the scope of the expert's knowledge seems adequate, the testimony is not admissible unless it is based upon the witness' actual

<sup>137</sup> *Id.* at 1358. In contrast, in *Hardy v. Brantley*, the court determined that the plaintiff's medical malpractice expert was a qualified witness in the medical field. *Hardy*, 471 So. 2d at 366. The proffered expert had a medical degree, was Board-certified, practiced primarily in emergency medicine, which was the field at issue in the litigation, and held prestigious positions within the medical community. *Id.* The Mississippi Supreme Court properly reversed the trial court's directed verdict for the defendant hospital. *Id.*

<sup>138</sup> *Id.* at 1358 (citing *Hall*, 466 So. 2d at 875). The Mississippi Supreme Court's adherence to this view is deeply rooted and such examples may be found in earlier cases such as *Glens Falls Ins. Co. v. Linwood Elevator*, 130 So. 2d 262 (Miss. 1961). In that case, the court clearly stated that "[b]eing a physician and surgeon [is] not . . . the test of competency" in determining the issue of causation. *Glens Falls Ins. Co.*, 130 So. 2d at 268; see also *Goforth*, 603 So. 2d at 329 (affirming trial court's exclusion of expert testimony where expert was qualified in making dental appliances but not specially knowledgeable about effect of partial bridge in plaintiff's mouth).

<sup>139</sup> *Goodson*, 566 So. 2d at 1144. In *Goodson*, the Mississippi Supreme Court held that the trial court erroneously allowed plaintiff's expert to offer an opinion on the psychological state of the allegedly abused child. *Id.* Plaintiff's expert was a licensed physician but the record did not show that she had specialized training in the field of psychology. *Id.* Although the court admitted the expert's testimony regarding her physical examination of the child, the court did not allow into evidence the offered psychological testimony. *Id.* at 1145. The court held that the expert did not have "the professional competence to give the opinion at issue with the level of reliability our law demands of evidence offered at trial." *Id.* at 1145-46; see *Dawsey v. Olin Corp.*, 782 F.2d 1254, 1264 (5th Cir. 1986) (affirming trial court's ruling that expert in chemistry precluded from testifying because of lack of knowledge of toxicology); *Aponaug Mfg. Co. v. Carroll*, 184 So. 63, 65 (Miss. 1938) (holding x-ray technician competent to testify about what x-rays showed but not about causation).

experience and training and not merely on abstract research.<sup>140</sup>

Finally, Mississippi Rule 702 requires that the proffered expert testimony be sufficiently connected to the pertinent facts and issues. In the case of *West v. State*,<sup>141</sup> the Supreme Court of Mississippi reversed and remanded defendant's conviction of capital murder and sexual assault.<sup>142</sup> In that case, the prosecution sought to prove that the defendant murdered the victim and then sexually assaulted her.<sup>143</sup> The prosecution attempted to offer expert opinion testimony that the defendant was a known necrophiliac.<sup>144</sup> The court excluded this "free floating lecture on psychosexual disorders" because the expert failed to state that the defendant actually suffered from necrophilia and did not relate his knowledge to the facts of defendant's case.<sup>145</sup>

### B. Mississippi Rule of Evidence 703

Mississippi Rule 703 requires trial courts to exclude expert testimony which is based on hearsay evidence if it is not based on facts and data reasonably relied upon by other experts in the field.<sup>146</sup> Similarly, an expert's testimony is admissible only where the opinion is based on methodologies and studies generally accepted within the requisite field.<sup>147</sup> In addition, the Supreme Court of Mississippi has held that for expert opinion to have a sufficient factual basis, such opinion must be

---

<sup>140</sup> See *Byrd v. F-S Prestress, Inc.*, 464 So. 2d 63, 69 (Miss. 1985); see also *In re Paoli R.R. Yard PCB Litig.*, Master File No. 86-2229 (E.D. Pa. Oct. 21, 1992), Paoli: Order on Motion in Limine to Exclude Opinion Testimony of Jannette D. Sherman, M.D., slip op. at 46 (holding experience gained primarily through library research insufficient to qualify expert in field of toxicology).

<sup>141</sup> 553 So. 2d 8 (Miss. 1989).

<sup>142</sup> *West*, 553 So. 2d at 11.

<sup>143</sup> *Id.* at 10.

<sup>144</sup> *Id.* at 19-20.

<sup>145</sup> *Id.* at 20.

<sup>146</sup> MISS. R. EVID. 703.

<sup>147</sup> *House*, 445 So. 2d at 822.

based upon the expert's personal analysis of the requisite facts.<sup>148</sup> It is not sufficient for experts to rely entirely on information furnished to them by third parties.<sup>149</sup> Thus, courts may properly exclude medical expert testimony that is not based on some professional review by the proffering expert.<sup>150</sup>

## VI. CONCLUSION

Although *Daubert* did not provide a "bright line test" to solve the problems of admitting scientific evidence - especially evidence at the "cutting edge" of science - in trials, the decision did make a major contribution to the resolution of these complex issues by recognizing the obligations of the trial judge to become more active in the process and to do so before the jury hears any expert evidence. This call for judges to become "gatekeepers" should ensure the reliability of scientific evidence presented to juries and thereby improve the quality of justice.

*Daubert* also provides trial attorneys with an important analysis of the relationship of Rules 702, 703, 403, and 104 of both the Federal and Mississippi Rules. These rules should be followed aggressively to present favorable scientific evidence and to limit or exclude harmful scientific evidence. Some may conclude that the language used in the Supreme Court analysis was over-broad. However, even these scholars and litigators must recognize that the mere fact alone that the United States Supreme Court addressed this evidentiary issue means that the Court placed importance upon the matter. In and of itself, this fact strengthens the position of those trial attorneys who insist upon careful scrutiny of expert evidence before a jury hears such evidence.

*Holley Davis Thames*

---

<sup>148</sup> *Hilcox v. Holleman*, 602 So. 2d 626, 638 (Miss. 1987); see *Hinds-Rankin Metro. Water & Sewer Ass'n v. Reid*, 256 So. 2d 373, 377 (Miss. 1971) (stating no factual basis exists for opinion when based on hypothetical questions).

<sup>149</sup> *Magnolia Hosp. v. More*, 320 So. 2d 793, 799 (Miss. 1975).

<sup>150</sup> *Palmer*, 564 So. 2d at 1358.





## MISSISSIPPI MUDSLINGING: THE SEARCH FOR TRUTH IN POLITICAL ADVERTISING\*

### I. INTRODUCTION

Mudslinging, smears, and outright lies have been an enduring feature of campaigns for public office in Mississippi for as long as elections have been held in the state.<sup>1</sup> With the advent of modern campaign techniques to Mississippi politics, the primary vehicle of these inaccurate and nonsubstantive claims is political advertising. Deceptive ads threaten the public interest in several ways.<sup>2</sup> Not only do misleading claims by candidates erode their opponents' support, but they also misdirect voter attention away from substantive issues and discourage qualified individuals from seeking public office.<sup>3</sup>

---

\* The author is a third year law student at the University of Virginia School of Law.

<sup>1</sup> In one of the most divisive elections in recent history, the 1983 gubernatorial contest, the Democratic nominee, Attorney General Bill Allain, was accused of having homosexual relations with male prostitutes. The charges were made public several weeks before the election by a supporter of Leon Bramlett, Allain's opponent, whose television advertising contended that Allain's moral character was the central issue in the campaign. Though Allain eventually won the post, the final days of the campaign were spent debating the charges, which later proved to be unfounded. See *Elections-Miss*, UPI, Nov. 8, 1983, available in LEXIS, Nexis Library, UPI File.

<sup>2</sup> Political scientists and commentators are divided over the effects of negative political advertising on voters and their expressed preferences for candidates during the electoral process. For an in-depth discussion of the controversial role of televised political advertising, see Rebecca Arbogast, *Political Campaign Advertising and the First Amendment: A Structural-Functional Analysis of Proposed Reform*, 23 AKRON L. REV. 209, 216-20 (1989); Atkin & Heald, *Effects of Political Advertising*, 40 PUB. OPINION Q. 216 (1976); Timothy J. Moran, *Format Restrictions on Televised Political Advertising: Elevating Political Debate Without Suppressing Free Speech*, 67 IND. L.J. 663, 664-73 (1992); Fred Barnes, *The Myth of Political Consultants*, NEW REPUBLIC, June 16, 1986, at 16 (taking skeptical view of efficacy of political advertising).

<sup>3</sup> See Note, *State Regulation of Political Broadcast Advertising: Stemming the Tide of Deceptive Negative Attacks*, 72 B.U. L. REV. 179, 186-91 (1992) [hereinafter *Stemming*].

In response to the negative effects of political misrepresentation on the electoral process, the Mississippi legislature has at various times enacted provisions intended to regulate the nature of political commentary and advertising.<sup>4</sup> This Article analyzes the constitutional validity and practical wisdom of several provisions of the Mississippi Election Code of 1986, which address two areas of regulatory concern: restrictions on false campaign statements<sup>5</sup> and prohibition of anonymous political advertisements.<sup>6</sup> The Article concludes that while these provisions have the public interest at heart, they fail on both constitutional and practical grounds.

Part I of the Article provides the constitutional backdrop for a discussion of the Mississippi Election Code by examining the relatively small body of First Amendment jurisprudence on state regulation of political speech and advertising. Part II applies this constitutional framework to Mississippi's campaign falsity statute and concludes that the provision violates the First Amendment; several suggestions for this measure's reform are discussed. Part III analyzes the constitutionality of the state's ban on anonymous advertisements and concludes that this provision also offends the First Amendment's guarantee of free speech. Part IV assesses the practical effects of any type of regulation on political advertising and proposes several alternatives to the state's current system of restrictions, including the establishment of a Mississippi Fair Campaign Practices Committee.

This Article argues that while regulation of political speech seems appropriate in order to stem the tide of negative and deceptive campaign advertising, legal sanctions in this area

---

*the Tide*].

<sup>4</sup> The legislature's most recent and most comprehensive attempt to regulate election practices is the Mississippi Election Code of 1986, MISS. CODE ANN. §§ 23-15-1 to -1111 (1990). An account of the act's legislative history and a discussion of its improvements over the preceding patchwork of election laws is found in R. Andrew Taggart & John C. Henegan, *The Mississippi Election Code of 1986: An Overview*, 56 MISS. L.J. 535 (1986).

<sup>5</sup> MISS. CODE ANN. § 23-15-875 (1990).

<sup>6</sup> MISS. CODE ANN. §§ 23-15-897 to -899 (1990).



serve to chill the exercise of free speech and have minimal impact on the level of misleading campaign rhetoric. In order to elevate the level of political debate in Mississippi, legislators should repeal statutes that inhibit free speech and should encourage stronger extralegal coercion of candidates' behavior. In short, to ensure electoral integrity, state government must allow the marketplace of political ideas and information to flourish, subject only to the demands and restrictions of private citizens and independent political organizations.

## II. FIRST AMENDMENT JURISPRUDENCE

Mississippi's attempt to regulate political speech presents the somewhat novel question of whether state government can restrict certain speech by candidates and commentators in order to facilitate the free exchange of ideas and information, which forms the basis for more enlightened debate and informed self-government.<sup>7</sup> In general, because of the nation's strong commitment to free speech, state restrictions on protected political speech must withstand exacting constitutional scrutiny.<sup>8</sup> The relatively small body of case law and commentary on campaign speech regulation<sup>9</sup> requires examination of other First Amendment precedents.

A proper frame of reference for judging the constitutionality of campaign speech restrictions is provided by the often-cited opinions of Justices Holmes and Brandeis, which established the baseline First Amendment assumption that, without "free trade in ideas,"<sup>10</sup> democracy cannot survive. At the core of the notion that speech about public issues should be carefully guarded from government interference lies the strong concomi-

---

<sup>7</sup> See *Stemming the Tide*, *supra* note 3, at 197-98.

<sup>8</sup> *Id.*

<sup>9</sup> For a comprehensive discussion of the constitutional issues raised by the regulation of campaign speech and practices, see Note, *Developments in the Law — Elections*, 88 HARV. L. REV. 1111, 1272-98 (1975) [hereinafter *Elections*].

<sup>10</sup> *Abrams v. United States*, 250 U.S. 616, 630 (1919) (Holmes, J., dissenting); see *Whitney v. California*, 274 U.S. 357, 375-77 (1927) (Brandeis, J., concurring); *Gitlow v. New York*, 268 U.S. 652, 672 (1925) (Holmes, J., dissenting).

tant concern for unfettered expression of views about candidates for public office.<sup>11</sup>

In interpreting the guarantees of the First Amendment as applied to campaign speech, courts are faced with an apparent dilemma between the twin goals of robust, unfettered debate and enlightened democracy. Traditional jurisprudence counsels against any government interference with political speech, especially during elections, while political intuition suggests that without restraints on deceptive political advertisements that mislead the public and distort voter preferences, informed self-government cannot be attained. Courts are bound by precedent to narrowly construe restrictions so that political speech has "breathing space,"<sup>12</sup> while at the same time they are instructed that the First Amendment's protection does not extend to the promulgation of "calculated falsehoods"<sup>13</sup> or other patently deceptive speech.

Both provisions from the Mississippi Election Code point up the constitutional dilemma between preserving robust political debate and maintaining an enlightened electorate. This Article resolves that dilemma in favor of less government intervention in the political process.

### III. CAMPAIGN FALSITY

#### A. *Constitutional Background and Analogs*

Mississippi, along with sixteen other states,<sup>14</sup> prohibits the

---

<sup>11</sup> See *Monitor Patriot Co. v. Roy*, 401 U.S. 265, 271-72 (1971) ("[I]f it be conceded that the First Amendment was 'fashioned to assure the unfettered interchange of ideas for the bringing about of political and social changes desired by the people' . . . then it can hardly be doubted that the constitutional guarantee has its fullest and most urgent application precisely to the conduct of campaigns for political office.").

<sup>12</sup> See *Garrison v. Louisiana*, 379 U.S. 64, 73-74 (1964); *New York Times Co. v. Sullivan*, 376 U.S. 254, 271-72 (1964).

<sup>13</sup> *Garrison*, 379 U.S. at 75.

<sup>14</sup> For a list of these state statutory provisions, see Note, *When Political Campaigns Turn to Slime: Establishing a Virginia Fair Campaign Practices Committee*, 7 J. L. & POL. 363 n.45 (1991) [hereinafter *FCPC*]. For reaction to recent changes in the Washington state election code concerning campaign falsehoods, see Bruce Chapman,

making of false statements in political campaigns.<sup>15</sup> A violation of the Mississippi statute is limited to statements which are defamatory at common law — those which damage reputation, expose a person to contempt or ridicule, or cause a person to be shunned or avoided.<sup>16</sup> In order to initiate the prosecution of a violation, the affidavits of two credible citizens must be filed with a judicial officer, who then issues an arrest warrant for the alleged offender.<sup>17</sup> An accused person found to have violated the provision is guilty of a misdemeanor and fined five hundred dollars.<sup>18</sup>

Since Mississippi's campaign falsity provision essentially resembles a criminal libel statute,<sup>19</sup> any determination of its constitutionality must examine analogous First Amendment decisions involving the permissible scope of defamation actions brought by office-holders and candidates. The landmark case governing libel suits by public officials is *New York Times Co. v. Sullivan*,<sup>20</sup> a defamation action brought by a city commis-

---

*Policing Political 'Lies'*, WASH. POST, Oct. 26, 1992, at A21, col. 3.

<sup>15</sup> The statute provides in pertinent part:

No person, including a candidate, shall publicly or privately make, in a campaign then in progress, any charge or charges reflecting upon the honesty, integrity or moral character of any candidate, so far as his private life is concerned, unless the charge be in fact true and actually capable of proof; and any person who makes any such charge shall have the burden of proof to show the truth thereof when called to account therefor under any affidavit or indictment against him for a violation of this section. Any language deliberately uttered or published which, when fairly and reasonably construed and as commonly understood, would clearly and unmistakably imply any such charge, shall be deemed and held to be the equivalent of a direct charge. And in no event shall any such charge, whether true or untrue, be made on the day of any election, or within the last five (5) days immediately preceding the date of any election.

MISS. CODE ANN. § 23-15-875 (1990).

<sup>16</sup> See Note, *Campaign Hyperbole: The Advisability of Legislating False Statements Out of Politics*, 2 J. L. & POL. 405, 407 (1985) [hereinafter *Campaign Hyperbole*].

<sup>17</sup> MISS. CODE ANN. § 23-15-875 (1990).

<sup>18</sup> *Id.*

<sup>19</sup> See *Manasco v. Walley*, 63 So. 2d 91 (1953) (interpreting § 23-3-33 of the 1972 code, which required newspapers to provide reply space for candidates subjected to editorial criticism, as analog to state's criminal libel statute). For further discussion of this case and the code provision, see *infra* notes 46-49 and accompanying text.

<sup>20</sup> 376 U.S. 254 (1964).



sioner against a newspaper that printed a defamatory political advertisement.<sup>21</sup> The Supreme Court reasoned that a "public official" could not recover damages for a defamatory attack unless the official could prove with convincing clarity that the statements were made with "actual malice," which the Court defined as acting with knowledge that — or with reckless disregard for whether — the statements were false.<sup>22</sup>

Three years later, the Court expanded the applied meaning of "public official" to include defamatory statements about all "public figures."<sup>23</sup> In a subsequent decision, the Court affirmed this extension of the *New York Times* privilege, reasoning that persons in the public eye have greater access to the media to correct false statements than private citizens.<sup>24</sup> Thus, using access to the corrective power of the media as a gauge of the claimant's public persona, courts certainly consider political candidates to qualify as "public figures."<sup>25</sup>

### B. Statutory Defects

Mississippi's campaign falsity provision suffers from two constitutional defects. First, it perpetuates a legally irrelevant distinction between the public and private lives of candidates and office-holders. Second, and more important, one part of the statute's definition of libel does not comport with *New York Times*. Its ban on character attacks in the five days preceding an election poses a serious threat to free political speech. While only the latter constitutional infirmity is necessarily fatal to the

---

<sup>21</sup> *New York Times*, 376 U.S. at 256-57, 282-83. For an extensive account of the case, see generally A. LEWIS, *MAKE NO LAW: THE SULLIVAN CASE AND THE FIRST AMENDMENT* (1991).

<sup>22</sup> *Id.* at 279-80; see also *Monitor Patriot*, 401 U.S. at 270-71.

<sup>23</sup> *Curtis Publishing Co. v. Butts*, 388 U.S. 130, 155 (1967).

<sup>24</sup> *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 342 (1974).

<sup>25</sup> See *Monitor Patriot*, 401 U.S. 265 (applying "actual malice" standard to libel action brought by candidate against newspaper that printed defamatory statements about him); *Ocala Star-Banner Co. v. Damron*, 401 U.S. 295 (1971) (same); see also James A. Albert, *The Remedies Available to Candidates Who Are Defamed by Television or Radio Commercials of Opponents*, 11 VT. L. REV. 33, 51 (1986); *Elections*, *supra* note 9, at 1279-80.

current statute, a variety of solutions present themselves to a willing legislature.

The provision's less offensive and more easily remediable fault is its distinction between allegedly defamatory statements that relate to the "private life" of a political candidate and those that concern his or her "public life."<sup>26</sup> In part due to the same considerations that have led to the designation of candidates as public figures,<sup>27</sup> courts have made clear that the *New York Times* standard applies equally to speech concerning the private as well as the public life of a candidate.<sup>28</sup> In *Monitor Patriot Co. v. Roy*,<sup>29</sup> the Supreme Court reasoned that since almost every truthful statement about a candidate can be considered relevant to his or her capacity to hold office, a public/private distinction is unhelpful and meaningless.<sup>30</sup> Thus, if a primary

<sup>26</sup> The section prohibits statements "reflecting upon the honesty, integrity or moral character of any candidate, so far as his private life is concerned . . . ." MISS. CODE ANN. § 23-15-875 (1990) (emphasis added).

<sup>27</sup> See *supra* text accompanying notes 23-24. Several commentators have tried to explain courts' preference for the media access rationale over concerns for individual reputation in these cases. Some have argued that the state's interest in providing for an informed electorate and in protecting the integrity of the electoral process outweighs any putative private interest in individual reputation. See, e.g., Comment, *Misrepresentation in Political Advertising: The Role of Legal Sanctions*, 36 EMORY L.J. 853, 873 (1987) [hereinafter *Misrepresentation*]; *Elections*, *supra* note 9, at 1278-79. These observations miss the point to the extent that they reaffirm the judicially disfavored distinction between a candidate's public and private life. In a political campaign, a candidate's private life is indistinguishable from his public persona. Therefore, the court's recognition of the weighty state interest in preventing the deception of voters is also an implicit validation of the state's concomitant interest in insuring the untainted public perception of the reputations of candidates *qua* candidates.

<sup>28</sup> See *Ocala Star-Banner*, 401 U.S. at 300; *Monitor Patriot*, 401 U.S. at 272-75.

The Restatement (Second) of Torts has adopted a similar position:

§ 573 - Slanderous Imputations Affecting Business, Trade, Profession or Office  
One who publishes a slander that ascribes to another conduct, characteristics or a condition that would adversely affect his fitness for the proper conduct of his lawful business, trade or profession, or of his public or private office, whether honorary or for profit, is subject to liability without proof of special harm.

RESTATEMENT (SECOND) OF TORTS § 573 (1990) (emphasis added).

<sup>29</sup> 401 U.S. 265 (1971).

<sup>30</sup> *Monitor Patriot*, 401 U.S. at 274 ("The principal activity of a candidate in our political system . . . consists in putting before the voters every conceivable aspect of his public and private life that he thinks may lead the electorate to gain a good impression

goal of the First Amendment can rightly be construed as the promotion of a free flow of information about candidates for public office, "anything which might touch on an official's fitness for office is relevant."<sup>31</sup>

A more fatal defect in the campaign falsity statute is its partial nonconformity with the standards set forth by the Supreme Court. Under *New York Times*, a candidate cannot recover for allegedly libelous statements unless they were made with knowledge of their falsity. Under the Mississippi statute, false statements are properly prohibited only in cases of willful and knowing statements.<sup>32</sup>

The statute goes on, however, to prohibit personal attacks, whether true or untrue, during the last five days of a campaign.<sup>33</sup> This part of the provision is designed no doubt to protect the state's interest in deterring last-minute character assaults, which occur when there is little time for correction or rebuttal. Given the state's purpose of preventing the electorate's being misled, Mississippi could probably argue that broader regulation of falsity in the final stage of a campaign is necessary.<sup>34</sup> Although this interest certainly grows stronger as

---

of him.").

<sup>31</sup> *Id.* at 273.

<sup>32</sup> The section provides punishment for "[a]ny person who shall willfully and knowingly violate this section . . . ." MISS. CODE ANN. § 23-15-875 (1990). Under this measure, the defendant has the burden of proving the truth of an implicated statement. This evidentiary burden itself may violate the *New York Times* requirement that plaintiffs show falsity with "convincing clarity." See *New York Times*, 376 U.S. at 279-80. It is unclear under the Mississippi statute whether the prosecution has the burden of proving scienter.

<sup>33</sup> The section provides in relevant part that "in no event shall any such charge, whether true or untrue, be made on the day of any election, or within the last five (5) days immediately preceding the date of any election." MISS. CODE ANN. § 23-15-875 (1990). A proposal currently under consideration by the Mississippi legislature would amend this section to prohibit such activity for twelve days prior to any election. See H.R. 27, 162d Leg., Reg. Sess. (1994).

<sup>34</sup> For discussion of the proposition that deceptive claims are especially problematic in the final days of a campaign, see S. KELLEY, *POLITICAL CAMPAIGNING* 89 (1960); B. FELKNOR, *DIRTY POLITICS* 256-57 (1966).

Few other states attempt to control last-minute falsity. Several states, including Mississippi, bar punitive damages in libel actions if the defendant has published a retraction, but authorize such damages if the defamation and subsequent retraction



the election nears, it does not support the outlawing of protected speech by candidates which serves to inform the electorate.

In light of the Supreme Court's ruling in *Mills v. Alabama*,<sup>35</sup> Mississippi's ban on election-eve assaults is almost certainly unconstitutional. In *Mills*, the Court invalidated an Alabama statute<sup>36</sup> forbidding all speech relating to a campaign on election day.<sup>37</sup> Although the statute in *Mills* was narrower in temporal scope than the Mississippi measure, the latter similarly bans speech regardless of its falsity. Indeed, under a plain reading, the provision bans *all* political speech in the five days preceding an election. Just as the distinction between a candidate's public and private life is unhelpful, so too is any attempt to categorize statements as to whether they reflect upon an opponent's honesty and integrity. Since all of these statements are necessarily either true or false, they are all banned.<sup>38</sup> Therefore, in banning all true statements made by candidates as a campaign draws to a close, the state harms its own interest in providing for an informed electorate.<sup>39</sup>

### C. Suggestions for Reform

Despite the constitutional infirmities of Mississippi's campaign falsity provision, a variety of reform measures could

---

occur near the end of a campaign. See, e.g., ARIZ. REV. STAT. ANN. § 12-653.05 (1992) (retraction provision inapplicable to statement made within 30 days of election); IND. CODE § 34-4-15-1(a)(1)(c) (1986) (retraction must be made at least three days before election to avoid punitive damages); MISS. CODE ANN. § 395-1-5(5) (1990) (retraction provision inapplicable to statement made within 10 days); TENN. CODE ANN. § 29-24-103(b)(2) (1980) (retraction provision not applicable to statements made within ten days of election).

Since Mississippi is the only state to ban election eve accusations, the argument that the state's provision is necessary would probably fail.

<sup>35</sup> 384 U.S. 214 (1966).

<sup>36</sup> ALA. CODE tit. 17, § 285 (1958).

<sup>37</sup> *Mills*, 384 U.S. at 219-20.

<sup>38</sup> The provision also unwittingly bans statements by candidates who want to respond to false statements made by their opponents. Since a candidate's rebuttal must either call his or her opponent a liar or discuss the candidate's own moral character, there is no way to escape violating the provision.

<sup>39</sup> For a discussion of the constitutionality and deterrent effects of less restrictive bans on campaign speech encompassing only falsehoods or only those made negligently, see *Elections*, *supra* note 9, at 1286.

be considered by a state legislature intent on improving the level of political debate.<sup>40</sup> While none of these suggestions presents a foolproof solution to the problem of negative and deceptive campaigning, at a minimum, each preserves the state's interest in maintaining an enlightened electorate while

---

<sup>40</sup> The suggestions contained in the text by no means provide an exhaustive evaluation of the solutions suggested by commentators elsewhere. Other legislative options involve more specific regulation of campaign speech and greater control of the format and financing of political advertisements.

An alternative to the reduced regulation urged in this Comment is the creation of provisions more narrowly tailored to regulate the use of certain ambiguous terms or phrases. For example, the Ohio legislature has prohibited, among other election practices, the use of the term "re-elect" by a non-incumbent. OHIO REV. CODE ANN. § 3599.091(B)(1) (Anderson 1988). In *Pesttrak v. Ohio Elections Comm'n*, however, a federal district court struck down this and other portions of the statute on the grounds that they did not adopt the *New York Times* standard of "actual malice." 670 F. Supp. 1368 (S.D. Ohio 1987), *aff'd*, 677 F. Supp. 534 (S.D. Ohio 1988). Thus, it seems unlikely that a highly detailed and comprehensive cataloging of typical deceptive campaign practices would survive constitutional scrutiny. This conclusion no doubt pleases those commentators who fear the dangers to free speech posed by extensive restrictions on campaign speech.

Other political reformers have suggested that legislators steer clear of content-based restrictions on campaign speech and turn their efforts instead to regulation of the format of political advertisements. Some of the innovations offered include allowing only "talking-heads" ads on television, in which a candidate must address the camera during the entire spot, and a requirement that candidates personally appear in negative advertisements. See Scott M. Matheson, Jr., *Federal Legislation to Elevate and Enlighten Political Debate: A Letter and Report to the 102d Congress about Constitutional Policy*, 7 J.L. & POL. 73, 82-84, 127-29 (1990) (deeming personal appearance requirements unconstitutional); Moran, *supra* note 2, at 677-78, 695-702 (concluding that both proposals raise significant constitutional problems); *Misrepresentation*, *supra* note 27, at 908-16 (arguing that broader format restrictions should survive constitutional scrutiny).

Other reform proposals attempt to create incentives to wage fair campaigns by conditioning the provision of free advertising time and space or state election financing on a candidate's agreement to conform his or her advertising to certain guidelines, such as a talking-heads format, or to discuss certain policy issues. See Matheson, *supra*, at 78-82, 123-27; Moran, *supra* note 2, at 706-12 (declaring agreement to conform to specified format constitutional but mandated discussion of issues invalid); see also *Stemming the Tide*, *supra* note 3, at 207-08, 210-11 (proposing to link state financing to candidate's making personal appearance throughout all advertisements). Each of these creative proposals raises the much debated subject of the so-called "unconstitutional conditions doctrine," which could possibly serve to invalidate the reform measures offered. See Matheson, *supra*, at 111-17. Unfortunately, since Mississippi lacks the financial resources with which to entice candidates to agree to speech restrictions, the issue is probably academic.

also protecting the free exchange of ideas and information which is vital to public debate.

As an initial matter, the Mississippi campaign falsity statute should be amended to wholly conform to the standards set forth by the Supreme Court in *New York Times*.<sup>41</sup> The rewritten provision would ease judicial administration of falsity claims by opening up a relevant body of analogous precedents in jurisdictions that have adopted the Court's standards in their falsity statutes. The more strictly constructed law would also clear up many doubts and uncertainties shared by judges and candidates alike over the meaning of political defamation.<sup>42</sup> In addition, the provision would cover not only libelous attacks on opponents but also candidates' statements about their own positions and accomplishments.<sup>43</sup>

The amended campaign falsity statute should also include a requirement that an allegedly defamatory statement be

---

<sup>41</sup> An example of one state's attempt to comply with *New York Times* is Montana's "political criminal libel" provision, which provides in pertinent part:

It is unlawful for any person to make or publish any false statement or charge reflecting on any candidate's character or morality or to knowingly misrepresent the voting record or position on public issues of any candidate. A person making such a statement or representation with knowledge of its falsity or with a reckless disregard as to whether it is true or not is guilty of a misdemeanor.

MONT. CODE ANN. § 13-35-234(1) (1991).

Similar statutes in Ohio and North Dakota have withstood constitutional attack and have been found to satisfy the "actual malice" standard. See *Snortland v. Crawford*, 306 N.W.2d 614, 622-23 (N.D. 1981); *Dewine v. Ohio Elections Comm'n*, 399 N.E.2d 399 (Ohio Ct. App. 1978); cf. IND. CODE ANN. § 3-4-7-5 (Burns 1982) (no express requirement of showing of knowledge or reckless disregard) (repealed 1993); *Campaign Hyperbole*, *supra* note 16, at 416-17 (discussing constitutionality of Indiana statute).

<sup>42</sup> Mississippi courts have long been reluctant to set out the definitive contours of a political libel action. See *Boydston v. State*, 249 So. 2d 411 (Miss. 1971) (reversing criminal libel conviction and refusing to enforce state's criminal libel law as penal offense because common law elements were too indefinite); *Manasco v. Walley*, 63 So. 2d 91 (Miss. 1953) (refusing to extend liability under election code's mandatory reply provision for newspapers and concluding that statute, being penal in nature, should be strictly construed).

<sup>43</sup> Whether the statute would ever be extended to cover promises made by a candidate through the course of a campaign, however, is doubtful. For a discussion of the implications of such liability, see Stephen D. Sencer, Note, *Read My Lips: Examining the Legal Implications of Knowingly False Campaign Promises*, 90 MICH. L. REV. 428 (1991).



material or have a recognizable effect on a candidate's electoral prospects.<sup>44</sup> Such a requirement would provide an additional safeguard to frivolous suits and would decrease judicial wariness to enforce restrictions on free speech.

Constitutional objections to the current statute's ban on election-eve assaults can be alleviated as well. First, the five-day window of liability should be amended to address only *false* statements — those judged defamatory under the "actual malice" test used in the rest of the measure. In addition, in order to serve the state's strong interest in keeping the public informed while preventing misleading statements, the amended provision should place a higher penalty on libelous statements made in the waning days of a campaign.<sup>45</sup> In this manner, the state can deter last-minute attacks by candidates who are uncertain of the truthfulness of their charges, while at the same time leave "breathing space" for truthful, legitimate statements.

Finally, the state legislature should re-evaluate the statutory remedies for aggrieved candidates against their opponents and the print media. Currently, the Election Code contains a mandatory reply provision for newspapers charged with publishing stories or editorials that reflect poorly on a candidate.<sup>46</sup> This section clearly violates the Supreme Court's

---

<sup>44</sup> Adding a materiality requirement to campaign falsity statutes has been suggested by several authors. See *Campaign Hyperbole*, *supra* note 16, at 420; *Elections*, *supra* note 9, at 1281 n.273.

<sup>45</sup> The statute could impose a higher monetary penalty here or could provide an alternative remedy, such as immediate retraction or, in the worst cases, avoidance of an election. See *infra* note 49. For discussion of a less persuasive suggestion to lower the standard of care from knowledge or recklessness to negligence in order to deter last-minute falsity, see *Elections*, *supra* note 9, at 1286.

<sup>46</sup> The statute provides in part:

If during any election campaign in Mississippi any newspaper either domiciled in the state, or outside of the state circulating inside the State of Mississippi, shall print any editorial or news story reflecting upon the honesty or integrity or moral character of any candidate in such campaign or on the honesty and integrity or moral character of any candidate who was elected or defeated in such campaign, such newspaper shall, on the written or telegraphic request of such candidate or his agents, print in such newspaper not later than the second issue of such newspaper following the receipt of such request, a statement by the candidate or his duly accredited representative giving the candidate's reply. Such statement shall be printed in the exact language which

decision in *Herald Publishing Co. v. Tornillo*,<sup>47</sup> in which a similar statute directing newspapers to provide reply space for candidates who received adverse editorial comment was deemed unconstitutional.<sup>48</sup> Given the lack of any other civil remedies in the Election Code, there is a clear need for stronger remedial measures in order to deter falsity.<sup>49</sup>

---

the candidate or his representative presents and shall be printed as near as is practical on the same page, in the same position, and in the same type and headlines as the original editorial or news story reflecting on the candidate had been printed.

MISS CODE ANN. § 23-15-877 (1990).

See also *Manasco v. Walley*, 63 So. 2d 91 (Miss. 1953) (only case interpreting reply provision, constitutional issues not raised); H.R. 27, 162d Leg., Reg. Sess. (1994) (proposal to amend reply provision to raise fine to \$1000).

<sup>47</sup> 418 U.S. 241 (1974).

<sup>48</sup> *Tornillo*, 418 U.S. at 257 (quoting *New York Times*, 376 U.S. at 279). The Court stated that a "[g]overnment-enforced right of access inescapably 'dampens the vigor and limits the variety of public debate.'" *Id.* The Court noted that decisions made with respect to newspaper content are strictly an editorial exercise that do not permit government intervention. *Id.* at 258. Similar reasoning would most likely apply to a provision requiring the publication of immediate retractions. Cf. *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969) (upholding federal law requiring broadcast media to provide reply time for truthful as well as false speech).

<sup>49</sup> A more in-depth exploration of the range of remedies available to defamed candidates falls outside the scope of this Comment. For a general discussion of remedies in the election context, see Albert, *supra* note 25; *Elections*, *supra* note 9, at 1298-1339.

Some state election codes provide that when clear and convincing evidence proves that a false statement reversed an election's outcome, the result can be invalidated. See, e.g., OR. REV. STAT. § 260.532(2)-(9) (1983). Given their understandable concern about overturning the will of the electorate, courts have been reluctant to order forfeiture of public office, since such a remedy effectively disfranchises those who voted for the winner. See *Mosee v. Clark*, 453 P.2d 176, 178 (Or. 1969). Only two elections have ever been set aside under these laws. See *Matter of Contest of Election in DFL Primary*, 344 N.W.2d 826 (Minn. 1984); *Cook v. Corbett*, 446 P.2d 179 (Or. 1968); see also Note, *Avoidance of an Election or Referendum When the Electorate Has Been Misled*, 70 HARV. L. REV. 1077, 1087 (1957).

An alternative remedy is resort to a civil action for defamation seeking damages or a preliminary injunction to bar distribution of the allegedly defamatory statement. See George W. Echan, Jr., *The Use of Injunctions in Political Campaigns*, 49 L.A.B. BULL. 229, 231 (1974). At least one court, though, has held that preliminary injunctions imposed on candidates for public office violate their rights to freedom of expression. See *Wilson v. Los Angeles County Superior Court*, 532 P.2d 116, 122 (Cal. 1975).

Another less discussed solution mandates either the provision of reply space or time or an immediate retraction for only false statements. See *Elections*, *supra* note 9, at

#### IV. CAMPAIGN DISCLOSURE REQUIREMENTS

Along with forty-two other states,<sup>50</sup> Mississippi imposes criminal sanctions on persons who publish or distribute anonymous campaign literature and advertisements.<sup>51</sup> The state's election code also requires that the printer or publisher of such materials be identified on the face of the publication.<sup>52</sup> While there is no absolute answer to the question of these

---

1284-85.

<sup>50</sup> For a list of these state statutes, see *Elections*, *supra* note 9, at 1287 n.302.

<sup>51</sup> Section 23-15-897 provides in pertinent part:

No person shall write, print, post or distribute or cause to be distributed, a notice, placard, bill, poster, dodger, pamphlet, advertisement or any other form of publication (except notices, posters, and the like, which simply announce speaking date and invite attendance thereon) which is designed to influence voters for or against any candidate at any election, unless and until the same shall have been submitted to, and approved and subscribed by the candidate or by his campaign manager or assistant manager, which subscription shall in all cases be printed as so subscribed, and not otherwise.

MISS. CODE ANN. § 23-15-897 (1990).

Section 23-15-899 provides in pertinent part:

Every placard, bill, poster, pamphlet or other printed matter having reference to any election, or to any candidate, that has not been submitted to, and approved and subscribed by a candidate or his campaign manager or assistant manager pursuant to the provisions of Section 23-15-897, shall bear upon the face thereof the name and the address of the author and of the printer and publisher thereof . . . .

MISS. CODE ANN. § 23-15-899 (1990).

Circulation of anonymous literature attacking candidates has been a problem in recent elections. In the 1983 gubernatorial race, anonymous leaflets quoting pro-segregation statements made by candidate Evelyn Gandy during a 1963 campaign began appearing on car windows and street corners throughout the heavily black Delta region of the state. Gandy promptly apologized for the statements at a news conference. See *Commercial Appeal Letter Used in Mudslinging*, UPI, June 10, 1987, available in LEXIS, Nexis Library, UPI File. In the 1987 campaign for governor, anonymous letters were circulated suggesting that Democratic candidate Ray Mabus wanted to ban athletics at Mississippi State University and that he was a close friend of beleaguered former presidential candidate Gary Hart. The letter was a photocopy of a satirical letter to the Memphis *Commercial-Appeal*, written in 1979 by Raymond E. Mabus, the candidate's father, in which the elder Mabus suggested among other things that Mississippi State's athletic dormitory be converted into a home for the recently deposed Shah of Iran. *Id.*

<sup>52</sup> For a list of other states' provisions that require a similar facial disclosure, see *Elections*, *supra* note 9, at 1287 n.304.



provisions' constitutionality,<sup>53</sup> the requirements are very arguably invalid and would likely be deemed unconstitutional by a Mississippi court.

### A. *Constitutional Background*

The leading case on state regulation of anonymous circulars is *Talley v. California*,<sup>54</sup> in which the Supreme Court invalidated a municipal ordinance banning the distribution of anonymous campaign literature. In striking down the provision, the Court expressed its concern that requiring identification of the authors of handbills chills the exercise of First Amendment rights by persons or groups who hold politically unpopular beliefs and who fear political or economic retribution for the public expression of their views.<sup>55</sup>

Since *Talley*, several lower courts have had the opportunity to decide whether the Court's decision applies to similar state prohibitions on election literature, but nothing resembling a consensus has emerged from these opinions. In *Canon v. Justice Court*,<sup>56</sup> the California Supreme Court, reasoning that the public interest in clean, fair elections outweighed the marginal decrease in free speech, held that *Talley* did not apply.<sup>57</sup> In *Zwickler v. Koota*,<sup>58</sup> however, a federal district

---

<sup>53</sup> See Moran, *supra* note 2, at 703 ("[T]he question of whether a disclosure requirement is constitutional has no talismanic answer.").

<sup>54</sup> 362 U.S. 60 (1960).

<sup>55</sup> *Talley*, 362 U.S. at 64-65.

<sup>56</sup> 393 P.2d 428 (Cal. 1964).

<sup>57</sup> *Canon*, 393 P.2d at 231. The court stated, "It is clear that the integrity of elections, essential to the very preservation of a free society, is a matter 'in which the State may have a compelling regulatory concern.'" *Id.* (quoting *Gibson v. Florida Legislative Comm'n*, 372 U.S. 539, 546 (1963)); see also *Morefield v. Moore* 540 S.W.2d 873 (Ky. 1976) (upholding state requirement that certain political advertising be identified by phrase "paid for by," followed by names and addresses of payors); *Commonwealth v. Acquaviva*, 145 A.2d 407 (Pa. 1958) (upholding disclosure statute); *Griset v. Fair Political Practices Comm'n*, 12 Cal. Rptr. 2d 249 (1993) (upholding disclosure statute).

<sup>58</sup> 290 F. Supp. 244 (E.D.N.Y. 1968), *rev'd on other grounds sub nom.* *Golden v. Zwickler*, 394 U.S. 103 (1969).

court invalidated a New York disclosure statute very similar to Mississippi's.<sup>59</sup>

### B. Statutory Defects

Since a Mississippi court could choose to adopt either line of reasoning on this issue, it is worthwhile to evaluate the competing interests at stake under laws prohibiting anonymous literature and advertisements. In order to sustain its ban, a state must show that the prohibition is necessary to promote compelling state interests that cannot be furthered in less restrictive ways.<sup>60</sup> Courts and commentators have identified several interests in particular that are served by these statutes: preserving the political accountability of the authors,<sup>61</sup> providing voters with information with which to assess campaign appeals,<sup>62</sup> and deterring false attacks on candidates and falsely attributed statements.<sup>63</sup> Upon further examination, each of these purported interests fails as a justification for Mississippi's identification requirement.<sup>64</sup>

---

<sup>59</sup> *Zwickler*, 290 F. Supp. at 257 ("The tide of judicial thinking floods too strongly today in the estuary of First Amendment freedom for any tributary of government power in its exercise to overbear it."); see also *Wilson v. Stocker*, 819 F.2d 943, 947-50 (10th Cir. 1987) (invalidating Oklahoma prohibition of anonymous election publications); *State v. Burgess*, 543 So. 2d 1332, 1336 (La. 1989) (striking down similar Louisiana statute).

<sup>60</sup> See *Burgess*, 543 So. 2d at 1335; *State v. Fulton*, 337 So. 2d 866 (La. 1976).

<sup>61</sup> See *State v. Babst*, 135 N.E. 525 (Ohio 1922) (finding statute valid because intended to fix responsibility for abuse of right of speech on speaker); *Moran*, *supra* note 2, at 704 (analyzing analogous cases on similar federal disclosure requirements).

<sup>62</sup> See, e.g., *Canon*, 393 P.2d at 428, 431, 435, 439.

<sup>63</sup> See, e.g., *Morefield*, 540 S.W.2d at 874 (finding statute valid because it promotes honesty and fairness in the conduct of campaigns). One author also suggests that disclosure requirements facilitate rebuttal by candidates to false attacks, but answers the argument by noting that "[t]he lack of a name on a piece of literature does not negate a candidate's ability to correct false statements." *Elections*, *supra* note 9, at 1290.

<sup>64</sup> For a contrary conclusion, see *Moran*, *supra* note 2, at 706; *Elections*, *supra* note 9, at 1291. One author has proposed that the question of whether disclosure or anonymity is more compatible with the goals of the First Amendment should be answered by employing an "objective test," which weighs the relative importance of the disclosed information with the generality of the affected persons. Comment, *The Constitutional Right to Anonymity: Free Speech, Disclosure and the Devil*, 70 YALE L.J. 1084, 1126-28 (1961).

The state's interest in insuring that anonymous speakers are held politically accountable is arguably compelling because of the strong governmental interest in providing voters with pertinent information, in this case the source of campaign materials.<sup>65</sup> The Supreme Court, however, has indicated that some groups have a right to remain anonymous when promulgating a political message.<sup>66</sup> These decisions rest on the countervailing First Amendment concern for protecting unpopular groups from persecution.<sup>67</sup> Therefore, accountability should be preserved by less broad and drastic means than compelled identification.

Similarly, the state's goal of informing the electorate of the names of political pamphleteers also reaches too far into the confines of protected speech. The purpose behind this goal — to aid the public in evaluating the interest, bias or credibility of the speaker<sup>68</sup> — does not compel an identification requirement. Under the First Amendment, voters are to be left free to decide

---

<sup>65</sup> For the courts' acceptance of this justification in reviewing federal disclosure statutes, see *United States v. Insko*, 365 F. Supp. 1308, 1312 (M.D. Fla. 1973); *United States v. Scott*, 195 F. Supp. 440 (D.N.D. 1961). The reasoning behind the different treatment of disclosure provisions at the state and federal level is elusive. Perhaps courts reason that the national interest in preserving accountability is more strongly justified on a national level because groups who have access to the television media and can afford to advertise there are never the kinds of groups subject to so much persecution that anonymity is required. See *Insko*, 365 F. Supp. at 1312.

<sup>66</sup> See, e.g., *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449 (1958). Courts have also stressed that the *Talley* opinion, in striking down California's ban on anonymous literature, traces the history of anonymity as it relates to free speech and refers almost exclusively to political publications. See *State v. North Dakota Education Ass'n*, 262 N.W. 2d 731, 734-35 (N.D. 1978); *Griset*, 12 Cal. Rptr. 2d at 257.

<sup>67</sup> *Talley*, 362 U.S. at 64-65; *NAACP v. Alabama*, 357 U.S. at 462-63.

<sup>68</sup> The *Talley* court explained this purpose:

Anonymity all too often lends itself, in the context of attacks upon candidates in the preelection period, to smears, as a result of which the electorate is deceived. Identification permits confrontation and often makes refutation easier and more effective. It tends to reduce irresponsibility. It enables the public to appraise the source.

*Talley*, 362 U.S. at 65. For a criticism of this general approach, see *Elections*, *supra* note 9, at 1291 n.321.



for themselves how much credibility to accord to anonymous leaflets.<sup>69</sup>

Finally, the state's interest in requiring disclosure to aid in deterrence of false campaign claims also fails to pass constitutional muster. The governmental interest involved here is identical to the basic purpose behind regulation of deceptive campaign speech — insuring electoral integrity by preventing misinformed voters.<sup>70</sup> However, since Mississippi's statute is not confined to forbidding deception, but instead undertakes to punish literature without any reference to whether speech falls within illegal categories of defamation or obscenity, Mississippi has created a stricter regulation than that allowed under the *New York Times* "actual malice" standard.<sup>71</sup>

In essence, then, Mississippi's disclosure statute is unconstitutionally overbroad on its face because it acts as a restraint on free expression by prohibiting anonymity in protected areas.<sup>72</sup> While the state's interests in accountability, information and falsity are important concerns, they are outweighed by the free speech rights of groups wishing to remain anonymous. The state's only interest that justifies a restriction of speech is

---

<sup>69</sup> See *Commonwealth v. Dennis*, 329 N.E.2d 706 (Mass. 1975) (holding that any public interest in revealing source of communication so that recipient might assess its content in light of that source did not furnish constitutionally sufficient justification for prohibition of all anonymous campaign literature); see also *Griset*, 12 Cal. Rptr. at 258 (Wallin, J., dissenting).

<sup>70</sup> See *Elections*, *supra* note 9, at 1289.

<sup>71</sup> See *Burgess*, 543 So. 2d at 1335; *Ex parte Harrison*, 110 S.W. 709 (Mo. 1908). The Mississippi statute's lack of specificity also implies that issuing anonymous leaflets in praise of a candidate is no less a violation of the code than publishing handbills designed to damage an opponent. See *Griset*, 12 Cal. Rptr. 2d at 257 (Wallin, J. dissenting) (noting that similar California statute "applies to all political mailings, including those praising a candidate"); *People v. Bongiorno*, 23 Cal. Rptr 565 (1962) (noting that under state statute prohibiting anonymous political circulars, it would be as much violation to praise as to seek to damage through campaign literature).

<sup>72</sup> Under the First Amendment overbreadth doctrine, a court may invalidate an entire statute on its face if it sweeps constitutionally protected activities within its ambit. See generally Monaghan, *Overbreadth*, SUP. CT. REV. 1 (1981); Note, *The First Amendment Overbreadth Doctrine*, 83 HARV. L. REV. 844 (1970).

the prevention of falsity, but this regulation does not conform to the guidelines of *New York Times*.<sup>73</sup>

### C. *Suggestions for Reform*

Since the constitutionality of Mississippi's disclosure provision is such a close question, it is more difficult here than with campaign falsity legislation to present a clear case for outright repeal. As with the latter measure, though, while the ban on anonymous literature is both practically unwise and constitutionally unsound, the provision can be saved by more careful tailoring.

First, in order to avoid a constitutional challenge to the statute by independent political groups, the law should be amended to apply only to candidates and their campaign committees.<sup>74</sup> This suggestion was offered in defense of California's disclosure requirement, but the court rejected such a narrow construction due to the statute's breadth.<sup>75</sup> More recently, however, a California court construed a similar measure to apply only to candidates and their committees.<sup>76</sup> If the Mississippi regulation were amended to apply only to these specific groups, it could possibly withstand claims of unconstitutional overbreadth.

---

<sup>73</sup> If §§ 23-15-897 and -899 are found unconstitutional, then by implication, § 23-15-879 is void and of no effect. This section exempts editorials in newspapers from the disclosure requirement so long as the editorial is not prohibited by the campaign falsity provision "or by some other prohibition of law." MISS. CODE ANN. § 23-15-879 (1990).

<sup>74</sup> One author has proposed that states limit disclosure requirements to advertisements in newspapers, major periodicals and the broadcast media, noting that "it is not likely that a lone dissident will have the sizeable resources needed for advertising in the mass media, thus limiting such regulations' chilling effect." *Elections*, *supra* note 9, at 1292 n.323. While perhaps a viable suggestion, this proposal ignores the stark dichotomy between large, well-funded political organizations and small, presumably one-person operations. In a state such as Mississippi, with its smaller media markets and lower advertising rates, it is not unthinkable that smaller political groups wishing anonymity would not be foreclosed financially from promulgating their message. This possibility argues against a provision that sets aside certain media markets for restrictions on anonymity.

<sup>75</sup> *Canon*, 61 Cal. 2d at 460-61.

<sup>76</sup> *Griset*, 12 Cal. Rptr. 2d 249 at 252-55. Legislatures need only take care in specifically defining what constitutes an official committee for purposes of applying this distinction.

Second, since the concern underlying disclosure requirements is largely a fear of the use of falsely attributed statements and false names, the legislature could more effectively proscribe this behavior through a narrowly drawn false attribution provision.<sup>77</sup> This measure would be a less drastic means of preventing deception and would also avoid the selective chill imposed on unpopular groups by bans on anonymous literature.

Finally, the current statute should be amended to remove required disclosure of the printer and publisher of campaign literature. In *Printing Industries of Gulf Coast v. Hill*,<sup>78</sup> a Texas district court held that a statute identical to the Mississippi regulation unconstitutionally infringed upon printers' freedom to print political matters anonymously, a right derived from the First Amendment's guaranty of freedom of the press.<sup>79</sup> Since the purpose of compelling identification of printers and publishers is not to inform voters but rather to aid in enforcement of the requirement that sponsors of the literature be disclosed,<sup>80</sup> it seems likely a court would determine that this part of the Mississippi provision places an unjustifiably heavy burden on the expressive interests of candidates and printers.

#### V. BEYOND STATE REGULATION: ELEVATING POLITICAL DEBATE

In sum, both sets of campaign regulations under consideration in this Article run counter to the First Amendment's guarantees of free speech. Mississippi's campaign falsity provision is definitely unconstitutional as written; the state's disclosure requirement poses a similar problem unless it can be more narrowly tailored to protect political expression.

---

<sup>77</sup> Several states specifically forbid false attribution or the use of false names. See GA. CODE ANN. § 21-2-560 (1987); OHIO REV. CODE ANN. § 3599.09(B) (Anderson 1988); VA. CODE ANN. § 24.1-277(3) (1992).

<sup>78</sup> 382 F. Supp. 801 (S.D. Tex. 1974).

<sup>79</sup> *Hill*, 382 F. Supp. at 804-813.

<sup>80</sup> See *Elections supra* note 9, at 1290 n.319.



Beyond questions of legality, however, campaign falsity and disclosure statutes are inadvisable on both political and practical, administrative grounds. At best, even if amended to rescue it from constitutional invalidity, the former provision will deter only the most malicious and false statements about candidates; the latter will merely provide voters with the names of supporters of particular candidates. Without more, neither will improve the level of debate during Mississippi elections. What is needed instead is a greater degree of extralegal, nongovernmental regulation of campaign practices — a sort of revitalization of the political marketplace by the press, the public and independent political organizations.

#### A. Administrative and Political Problems

Several practical drawbacks to both types of campaign restrictions argue against reliance on the election code for improving the quality of campaigns. Lack of enforcement looms largest among these problems, as courts are reluctant to construe campaign falsity statutes very broadly.<sup>81</sup> Mississippi courts have not often been confronted with political defamation suits and thus have rarely passed judgment on the viability of such attempts to clean up the political forum.<sup>82</sup>

---

<sup>81</sup> In practice, in the states which outlaw false campaign statutes, the prohibitions are construed so narrowly that the effect on political advertising is minimal. See *Campaign Hyperbole*, *supra* note 16, at 410-14 (reviewing sparse collection of cases); *Misrepresentation*, *supra* note 27, at 901 (noting that while these statutes seem to give courts a mandate to censor speech, "the threat exists only in theory . . . [because] these statutes have been nearly interpreted out of existence"); see also *Moran*, *supra* note 2, at 674-75 (discussing general inadequacies of campaign falsity statutes).

While the administrative problems associated with campaign falsity statutes are more readily evident than those arising from disclosure requirements, the latter pose practical concerns of inefficiency and poor enforcement as well. See *Elections*, *supra* note 9, at 1290 n.319.

<sup>82</sup> One of the few successful reported political defamation suits in Mississippi is *Krebs v. McNeal*, 76 So. 2d 693 (Miss. 1955). In that case, a candidate for sheriff sued his opponent who had made slanderous statements to a group of citizens and the editor of the local newspaper. In commenting on the plaintiff's claims that his automobile had been shot at recently, the defendant told the editor that "it was a put-up job and a hoax done by [the plaintiff] to influence the election." *McNeal*, 76 So. 2d at 697. The court affirmed the trial court's judgment for the plaintiff. *Id.* at 699.

Falsity statutes in Mississippi and other jurisdictions have also been infrequently enforced because they have not often been invoked by aggrieved candidates.<sup>83</sup> This failure to file claims stems no doubt from courts' unwillingness to find defamation, but candidates are also deterred from bringing suit by the slowness of the judicial process and their corresponding need for a quick remedy.<sup>84</sup>

The upshot of candidates' reluctance to invoke election laws and courts' refusal to enforce them is that only the most obviously false statements are punished.<sup>85</sup> Unfortunately, judicial attention to only the most patent falsehoods allows the more troubling political misstatements — half-truths about a candidate's voting and attendance records, and ambiguous characterizations of an opponent's platform or position papers — to escape legal scrutiny.

Campaign falsity and disclosure provisions also raise an important political consideration: Both substitute the

---

More illustrative of the typical problem is *Manasco v. Walley*, 63 So. 2d 91 (Miss. 1933), in which an incumbent state representative alleged that a newspaper's editorial criticizing his vote on a bill for redesignation of state highways had greatly contributed to his defeat at the polls. *Walley*, 63 So. 2d at 92. The editorial complained that the bill removed two proposed local highways from a priority funding list, and inquired: "If Representative Walley wanted to serve Greene County's best interests, why was [sic] these highways removed from 'priority'?" *Id.* The court admitted that "the writer of the editorial had only an imperfect understanding of the program of highway legislation," but held that the editorial writer's misinterpretation of the plaintiff's voting record did not violate Mississippi's criminal libel statute. *Id.* at 94-95; see also *Boydston*, 249 So. 2d at 413 (citing *Oakes v. State*, 54 So. 79 (Miss. 1910), as only Mississippi libel law precedent) (reversing conviction).

<sup>83</sup> See *Misrepresentation*, *supra* note 27, at 876-78.

<sup>84</sup> See *Stemming the Tide*, *supra* note 3, at 202; *Elections*, *supra* note 9, at 1282-83 n.278.

For an argument that the bringing of unsuccessful libel suits has in fact deterred both constitutionally protected speech and the defamatory expression that libel law is intended to prevent and punish, see Constantini & Nash, *SLAPP/SLAPPback: The Misuse of Libel Law for Political Purposes and a Countersuit Response*, 7 J. L. & POL. 417 (1991).

<sup>85</sup> As one commentator has noted when assessing the efficacy of Oregon's campaign falsity provision: "[A] candidate will have to resort to the most obvious lies, the most glaring falsehoods, in order to violate the statute. Yet, it is precisely these types of clear-cut situations that present the least need for legal sanctions." *Misrepresentation*, *supra* note 27, at 885.

government's judgment for a voter's discretion to weigh the relative merits of election ideas and information. In the case of campaign falsity statutes, courts deny voters the privilege of making their own inferences about which statements are misleading or deceptive.<sup>86</sup> Even disclosure requirements, which at least have the attraction of forcing bright-line legal distinctions, reflect a legislative determination that voters cannot be trusted to respond rationally to information during political campaigns.<sup>87</sup> Thus, both provisions reflect a government refusal to acknowledge that the people best suited to determine whether voters will discount shaky allegations or ignore unsigned handbills are the voters themselves.<sup>88</sup>

### B. Suggestions for Reform

#### 1. Returning to the Marketplace of Ideas

There is an alternative way to improve the quality of political debate in Mississippi, which depends not on government regulation of campaign speech but on placing public and private pressure on candidates to disavow negative and

---

<sup>86</sup> This attitude is perhaps informed less by judicial paternalism than by a reluctance to enforce seemingly excessive restrictions on free speech. For detailed discussions of this type of strict judicial interpretation of the Oregon Corrupt Practices Act, see *Campaign Hyperbole*, *supra* note 16, at 413-14; *Misrepresentation*, *supra* note 27, at 878-89.

<sup>87</sup> See Moran, *supra* note 2, at 685; see also *infra* note 94 and accompanying text.

<sup>88</sup> Elaborating on this point, one court has opined:

Don't underestimate the common man. People are intelligent enough to evaluate the source of an anonymous writing. They can see it is anonymous. They know it is anonymous. They can evaluate its anonymity along with its message, as long as they are permitted, as they must be, to read that message. And then, once they have done so, it is for them to decide what is "responsible," what is valuable, and what is truth.

Schuster v. Mun. Ct., 167 Cal. Rptr. 447, 452 (1980) (quoting *People v. Duryea*, N.Y.S. 2d 973, 996 (1974)).

For a contrary argument that election laws in fact reflect — and do not prevent the expression of — the values of the electorate, see Note, *Gutter Politics and the First Amendment*, 6 VALPARAISO U.L. REV. 185, 212 (1971) ("If one state's electorate demands a higher standard of accuracy and fair play from politicians, it should be their right to do so.").



deceptive election tactics and to eschew nonsubstantive debate.<sup>89</sup> One solution, completely consistent with the goals of self-government and the First Amendment, is to return to the core notion of the public forum as a political marketplace of ideas, issues and information, all competing for public purchase.<sup>90</sup> In essence, this suggestion recognizes that the most effective way to combat misrepresentation by candidates for public office is to use the same forum in which the initial charges were made.<sup>91</sup>

Several valuable criticisms of this approach merit mention; each can be sufficiently rebutted. First, many scholars and commentators have expressed a deep skepticism about how a market theory of the First Amendment interacts with the practical realities of politics.<sup>92</sup> A common complaint is that without campaign speech regulations, candidates under assault are at a disadvantage when claims are made too late or when assertions are groundless.<sup>93</sup> The most powerful response to

---

<sup>89</sup> As the Supreme Court has stated:

There is . . . an alternative to this highly paternalistic approach. That alternative is to assume that this information is not in itself harmful, that people will perceive their own best interests if only they are well enough informed, and that the best means to that end is to open the channels of communication rather than to close them. . . . But the choice among these alternative approaches is not ours to make . . . . It is precisely this kind of choice, between the dangers of suppressing information, and the dangers of its misuse if it is freely available, that the First Amendment makes for us.

*Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 770 (1976).

<sup>90</sup> As Justice Holmes has written, "The best test of truth is the power of the thought to get itself accepted in the competition of the market." *Abrams*, 250 U.S. at 630.

<sup>91</sup> A recent example of a candidate's rebuttal of an opponent's misleading advertisement came in the 1988 race for U.S. Senate between Democratic Representative Wayne Dowdy and Republican Representative Trent Lott. In one of his televised advertisements, Dowdy attacked Lott, who served as Minority Whip in the House, for having a \$50,000 "chauffeur" at his disposal. Lott responded with an advertisement featuring the "chauffeur" himself, who turned out to be a Capitol Hill police officer, assigned to Lott because of his post in the congressional leadership. With that battle over, the campaign resumed. See *Backfire in Mississippi*, 20 NAT'L J. 2783 (1988).

<sup>92</sup> See, e.g., *Misrepresentation*, *supra* note 27, at 889-95 (doubting abilities of candidates, voters and press to control deceptive campaign practices).

<sup>93</sup> See *id.*; Moran, *supra* note 2, at 685-86. For a discussion of additional punitive measures and alternative remedies to alleviate the concern about last-minute attacks

this criticism is that these factors are inherent in democracy and involve many of the same practical considerations as under existing election codes. That being the case, it is probably better to err on the side of the First Amendment and less regulation.

Another more theoretical criticism of the "free trade in ideas" concept argues that the marketplace metaphor makes the questionable assumption that "people will be able to use their rational capacities to eliminate [candidates'] distortions."<sup>94</sup> While voters may or may not act with some irrationality, the "realist" argument fails to consider whether courts are better situated than the public to evaluate misleading and negative claims in political advertising. As one judge has written: "[N]othing in the First Amendment or the case law suggests that any jurist or jurists have either the knowledge or the power to determine the best way to conduct political campaigns or inform the electorate."<sup>95</sup>

A final perspective on the political marketplace, which contrasts starkly with the preceding criticism but predicts a similar result, is offered by public choice theorists. In seeking to explain why the First Amendment exempts some types of speech but not others from protection, some scholars have pointed to the fact that political information, what the amend-

---

see *supra* notes 45, 49.

<sup>94</sup> Moran, *supra* note 2, at 685. Scholars would do well to heed a statement by the political scientist, V. O. Key, Jr.:

[V]oters are not fools. To be sure, many individual voters act in odd ways indeed; yet in the large the electorate behaves about as rationally and responsibly as we should expect, given the clarity of alternatives presented to it.

V.O. KEY, JR., *THE RESPONSIBLE ELECTORATE* 7 (1966).

<sup>95</sup> *Griset*, 12 Cal. Rptr. at 257; see also *supra* notes 86-88 and accompanying text (discussing political problems with regulations).

A more forceful observation often made in this context is to point out the seeming contradiction between the marketplace concept and the presupposition of defamation jurisprudence that a lie will not always be caught by the public. See *Elections, supra* note 9, at 1279 n.265. One possible response is to suggest that courts realize the practical limits of public monitoring of the political marketplace and have decided to step in to restrict free speech and to protect electoral integrity only when there is the possibility of great damage to self-government and when the corresponding restraint on speech is minimal and well-justified.

ment most strongly protects and nurtures, is an essential public good.<sup>96</sup> Therefore, they argue, it is likely to be undervalued by both the market and the political system, leading to underproduction of information about candidates, their ideas and positions.<sup>97</sup>

The proponents of this perspective differ from those who fear an irrational electorate because they provide a more plausible explanation of why voters remain apathetic in the face of misrepresentation by candidates. Moreover, the public choice model's assumption that voters are rational, self-interested actors is merely descriptive and does not posit a normative judgment about how (or whether) nonregulatory reform should be attempted.

This final point is crucial because, however idealized the notion of a political marketplace, there are ways to improve its efficiency — that is, to insure clean, fair elections that serve the public interest — which do not involve government regulation of campaign speech. If one takes as the root assumption of both the realist and public choice perspectives that information about candidates is the key to enlightened self-government, a solution is at hand. Responsible voters must find ways to increase the amount of political information circulated during campaigns and to convince other voters of the value of that information.<sup>98</sup>

---

<sup>96</sup> For the most recent and elaborate explanation of this perspective, see Farber, Comment, *Free Speech Without Romance: Public Choice and the First Amendment*, 105 HARV. L. REV. 554 (1991).

<sup>97</sup> See *id.* at 555, 558-62. In particular, Farber notes that political speech is a "double" public good, since voters can "free ride" on the efforts of other citizens in two ways. First, a person who does not bother to seek out information about candidates benefits nonetheless from the efforts of persons who do discover or produce relevant information. In addition, a nonvoter, who reasons that casting his or her marginal vote will not affect an election's outcome, benefits from the results of political participation by other persons who do vote. *Id.* at 563.

<sup>98</sup> This statement is based on an assumption used throughout this Comment, that deception is bad because it distorts the electoral process and weakens democracy. This observation may in fact be contrary to the opinions of that substantial number of voters who are not bothered enough by negative advertising. See *Stemming the Tide*, *supra* note 3, at 191-93 (discussing reasons for persistence of negative advertising). In any event, the solutions eventually offered *infra* allow both views of deceptive campaign



## 2. *The Press, the Public and Political Watchdogs*

An obvious source of more information about candidates and their positions is the press.<sup>99</sup> While many commentators remain skeptical of the media's ability to significantly improve the quality of campaigns,<sup>100</sup> accomplishments in recent years by members of the press in Mississippi and elsewhere suggest reason for cautious optimism.<sup>101</sup> A distant example of the positive role that the press can play is the Jackson *Clarion-Ledger's* series of articles on Mississippi public schools, which won the 1983 Pulitzer Prize for Distinguished Public Service.<sup>102</sup> Media can also mitigate the damage of election-eve smears by voluntarily refusing to accept political advertisements that contain serious new unproven charges against a candidate within five days of an election, or, perhaps better still, by exercising editorial judgment in publicizing new attacks during that period.<sup>103</sup>

---

practices to compete for public approval.

<sup>99</sup> See Shogan & Rosenthal, *Latest Wave of Campaign Reform Homes in on Media*, L.A. TIMES, May 7, 1990, at A1, col. 1 (summarizing proposals to improve media coverage); Bozell, *Annoy the Media, Elect Bush*, WALL ST. J., Nov. 2, 1992, at A16, col. 3 (suggesting more responsible role for media in monitoring elections).

<sup>100</sup> See, e.g., Moran, *supra* note 2, at 675-76; *Misrepresentation*, *supra* note 27, at 889-95 (providing anecdotal evidence supporting this assumption).

<sup>101</sup> After the 1988 presidential campaign, the media responded to criticism that they had failed to expose inaccuracies and deception in televised advertisements by monitoring ads more carefully and challenging candidates to prove their allegations. See Randal Rothenberg, *Newspapers Watch What People Watch in the TV Campaign*, N.Y. TIMES, Nov. 4, 1990, at D4, col. 1. During the 1992 election, even more attention was paid to the substance of both advertisements and campaign events. See COLUM. JOURNALISM REV., Nov.-Dec. 1992 (special issue entitled *Report Card on the Press: Covering a Runaway Campaign*).

<sup>102</sup> See KRANE & SHAFFER, MISSISSIPPI GOVERNMENT AND POLITICS: MODERNIZERS VERSUS TRADITIONALISTS 277 (1992) (discussing role of press in Mississippi in educating public and channelling and monitoring campaigns). Another example of the media's role in encouraging more substantive debates between candidates came in the 1988 Senate race between Lott and Dowdy, discussed *supra* note 91. On one Sunday during the battle of television advertisements about Lott's limousine driver, all five political columns in the Jackson *Clarion-Ledger* urged both candidates to tackle more important issues. See The MacNeil/Lehrer News Hour, Nov. 1, 1988, Tuesday Transcript #3292, available in LEXIS, Nexis Library.

<sup>103</sup> See B. FELKNOR, DIRTY POLITICS 256-57 (1966).

Given the current strong public reluctance to rely on the press, however, a more respected organization is needed as well. One solution worthy of consideration is the establishment of a citizen committee entitled the Mississippi Fair Campaign Practices Committee (MFCPC), which would have as its purpose the elevation of political debate during campaigns in Mississippi.<sup>104</sup> The Committee would be a private citizens' group, with no legal authority and no connection to the government of Mississippi. It would be funded entirely by private monetary and in-kind contributions.

The Committee's major activity would involve the writing and promulgation of a voluntary code of fair campaign practices, which candidates would be urged to sign and follow. The Committee would then monitor candidates' compliance with the code, and gather information about charges of misleading statements brought to its attention. In essence, the MFCPC would play a nonadjudicatory, publicizing role and would not arbitrate charges of unfair campaign practices unless opposing candidates signified their desire to be bound by the results.

While similar bodies formed in other states have met with their fair share of criticism,<sup>105</sup> the recent successes of some reform-minded Mississippi groups, such as Common Cause and Mississippi First, in overcoming voter apathy and organizational problems provide room for optimism.<sup>106</sup> In addition, the tactics of political suasion used by groups such as the MFCPC would lie much closer to the notion of democratic change embodied in the First Amendment than do government enforced

---

<sup>104</sup> Most of the ideas contained in the text are adopted from a recent proposal to establish a voluntary campaign watchdog organization in Virginia. See *FCPC, supra* note 14; see also *Stemming the Tide, supra* note 3, at 206, 208-09 (proposing creation of similar organization for Massachusetts).

<sup>105</sup> See Moran, *supra* note 2, at 676-77.

<sup>106</sup> The experience of Mississippi First in pushing for educational reform is encouraging. Formed in 1982 as a response to the defeat of educational reforms by the Mississippi legislature, the group raised nearly \$100,000 in 1983 for the state legislative elections, targeting fifty races and winning over half. The organization raised voter awareness of candidates' positions on the issues by publishing a newsletter and raised funds using direct-mail techniques. See KRANE & SHAFFER, *supra* note 102, at 55, 77, 277.

restraints on campaign speech.<sup>107</sup> Indeed, even if the MFCPC fails to improve candidate behavior immediately, it can still play a symbolic role by encouraging more respectable conduct.

## VI. CONCLUSION

Since political deception in Mississippi is so common, and its prevention so difficult, systematic regulation of elections is both useless in elevating the level of debates and dangerous to the First Amendment. However, if the Mississippi Election Code can be amended to provide legal sanctions within constitutional limits, the state legislature should act. The mere fact that some regulations impinge on free speech should not lead to the repeal of every campaign restriction. "The law," Justice Holmes noted in another context, "does all that is needed when it does all that it can."<sup>108</sup>

Once the Election Code has been amended, the integrity of the electoral process will lie in the hands of Mississippi voters, the press and political organizations. With a legal system in place to prevent the most dangerous inaccuracies and deceptive practices by candidates for public office, private citizens and political groups — possibly a Mississippi Fair Campaign Practices Committee — must raise public awareness of candidates' campaign stands and the truthfulness of their political advertisements. Then, the public must act on the basis of this information in order to guard against distortion and deception. Ultimately, in a democracy, the burdens of informed self-government must be shouldered by the voters themselves.

*Lance Conn*

---

<sup>107</sup> The MFCPC would represent a community evaluation of the standards expected of candidates, much in the same way that the American jury system provides for a representative group of citizens to evaluate their peers' behavior.

<sup>108</sup> *Buck v. Bell*, 274 U.S. 200, 208 (1927).











## ANNOUNCEMENT

We have purchased the  
entire back stock and  
reprint rights of —

### MISSISSIPPI LAW JOURNAL

---

Complete sets to date  
are now available. We  
can also furnish single  
volumes and issues.

---

FRED B. ROTHMAN & CO.  
10368 W. Centennial Rd.  
Littleton, Colorado 80123

---

The *Mississippi Law Journal* (USPS No. 354-300) is published three times annually in Spring, Fall, and Winter, Editorial and business offices: *Mississippi Law Journal*, Law Center, University Circle, Room 111, University, Mississippi 38677-0849.

Current subscription: \$35.00 per year. Single issue: \$12.00. Subscriptions are renewed automatically upon expiration unless the subscriber sends notice of termination. For information about subscriptions, please call (601)232-7361, Extension 111.

POSTMASTER: Send address changes directly to *Mississippi Law Journal*, Law Center, University Circle, Room 111, P.O. Box 849, University, Mississippi 38677-0849. Include name, new address (including zip code), and old address. Please notify 45 days in advance to ensure prompt delivery.

Unless a claim is made for nonreceipt of *Journal* issues within 6 months after the mailing date, the *Mississippi Law Journal* cannot be held responsible for supplying those issues without charge.

---

Citations conform to A UNIFORM SYSTEM OF CITATION (15th ed. 1991).

The *Mississippi Law Journal* is a member of the National Conference of Law Reviews.

---

To offer its contributors complete freedom, the *Journal* assumes no responsibility for the views expressed herein.

# A MATTER OF TIME.

There's a difference between Trustmark Financial Services and the other firms that offer you investments.

It's a matter of time.

We invest our time—as much as it takes—to get a clear picture of your financial goals, your confidence in investing and your risk tolerance.

*Then, and only then, we recommend.*

So, come talk with us about your needs.

We can help you with:

- Performance Funds
- Mutual Funds
- Self-Directed IRAs
- Discount Brokerage
- U.S. Government and Municipal Bonds

Call 354-5136, 1-800-533-9804, or contact the nearest Trustmark office.



**TRUSTMARK FINANCIAL SERVICES, INC.**  
*Investments for the Individual*

The investment advisor for the Performance Funds is Trustmark National Bank. Furman Selz Inc. is the Fund's distributor and sponsor, and is unaffiliated with the Bank. The Performance Funds are not obligations of Trustmark National Bank nor are they FDIC insured.

A wholly owned subsidiary of Trustmark National Bank.  
Member, National Association of Securities Dealers  
Securities Investor Protection Corporation

